

2000 APEC Economic Outlook



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TABLE OF CONTENTS

Foreword

CHAPTER 1: ECONOMIC PERFORMANCE AND PROSPECTS IN THE APEC REGION

1.1	Recent Developments and Prospects	1
1.1.1	<i>Favorable Growth in the APEC Region</i>	1
1.1.2	<i>Slow Increase in Prices</i>	4
1.1.3	<i>Labor Opportunities Diverse in the Region</i>	6
1.1.4	<i>External Sector Performance : Reversed</i>	8
1.1.5	<i>Prospects</i>	11
1.2	Policy Responses in Crisis-Hit and Developed Economies	18

CHAPTER 2: THE NEW REGIONALISM: IS IT A BUILDING BLOCK FOR MULTILATERALISM?

2.1	Introduction	22
2.2	The Value of MFN	25
2.3	Assessing RTAs	27
2.3.1	<i>Trade and Welfare Effects</i>	27
2.3.2	<i>Stumbling Blocks or Building Blocks?</i>	28
2.4	Some Empirical Illustrations	29
2.4.1	<i>Some Features of Existing RTAs</i>	31
2.4.1.1	<i>Comprehensiveness of Trade Liberalization</i>	31
2.4.1.2	<i>Levels of Protection vs. Nonmembers</i>	32
2.4.1.3	<i>Timeliness of Liberalization</i>	33
2.4.1.4	<i>Intra-vs. Extra-regional Trade</i>	34
2.4.1.5	<i>Trade Creation vs. Trade Diversion</i>	35
2.4.1.6	<i>Open Access to New Members</i>	36
2.4.1.7	<i>Towards Greater Integration</i>	37
2.4.1.8	<i>Other Issues</i>	37
2.4.2	<i>Prospective RTAs and Other Initiatives</i>	39
2.5	Conclusion	44

INDIVIDUAL ECONOMY REPORTS

• Australia	49
• Brunei Darussalam	55
• Canada	59
• Chile	65
• China	71
• Hong Kong, China	79
• Indonesia	85
• Japan	95

• Korea.....	101
• Malaysia.....	107
• Mexico	113
• New Zealand	119
• Papua New Guinea (no submission)	
• Peru	127
• The Philippines	133
• Russia.....	141
• Singapore	145
• Chinese Taipei	155
• Thailand	161
• United States of America	165
• Viet Nam.....	171

TABLES

CHAPTER 1

Table 1 Real GDP Growth in the APEC Region	2
Table 2 Consumer Price Index in the APEC Region.....	5
Table 3 Unemployment Rates in the APEC Region.....	7
Table 4 Current Account Balance.....	9
Table 5 GDP Growth Forecasts	12
Table 6 Foreign Exchange Rate and Stock Price Index.....	17
Table 7 Restructuring the Corporate Sector: Hardest Hit Asian Economies.....	20
Table 8 Restructuring the Banking Sector: Hardest Hit Asian Economies	21

CHAPTER 2

Table 1 Sub-regional Blocs Within APEC	30
Table 2 Intra-regional Trade Concentration Ratios	34
Table 3 Quantitative Studies of Regional Integration Arrangements	41

CHAPTER 1

Economic Performance and Prospects in the APEC Region

1.1 Recent Developments and Prospects

Favorable Growth in the APEC Region

The global economy expanded by 3.4 percent in 1999, up from 2.6 percent in 1998 (IMF 2000). Economic growth in the APEC region likewise accelerated from 2.2 percent in 1998 to 3.6 percent in 1999 (see Table 1). The recent financial crisis that adversely affected the Asian economies has been contained, and economic recovery was more prevalent in the region. The *United States'* economy continued to experience an exceptional growth track, both in terms of duration and strength. The output growth that started in March 1991 has been steadily increasing and is now into its 10th year. In 1999, real GDP grew by 4.2 percent, almost the same as the previous year's growth. Robust growth in personal consumption, private/business sector investment and residential investment fueled the growth in GDP. *Canada* experienced improvements in output spurred by strong domestic and foreign demand. Real GDP grew by 4.5 percent in 1999, 1.2 percentage points higher than 1998.

The Latin American member economies posted encouraging growth rates in 1999, led by *Mexico*, which recorded a 3.7 percent increase compared to the previous year's growth rate of 4.8 percent. The expansion in private/business sector investment and the export sector largely contributed to *Mexico's* economic growth. Meanwhile, *Peru's* economy started to recover from the negative effects of the *El Niño* weather phenomenon, deterioration in the terms of trade following the Asian Financial Crisis, and the international financial market turbulence. It posted a positive growth of 1.4 percent in 1999, a much better economic performance compared with the 0.4 percent contraction recorded in 1998.

Table 1
Real GDP Growth in the APEC Region
in Percent Change

	1995	1996	1997	1998	1999
Western Hemisphere	2.5	3.5	4.4	4.2	4.1
Canada	2.8	1.5	4.4	3.3	4.5
Chile	10.6	7.4	7.4	3.9	-1.1
Mexico	-6.2	5.2	6.8	4.8	3.7
Peru	8.6	2.5	6.7	-0.4	1.4
The United States	2.7	3.6	4.2	4.3	4.2
Northeast Asia	3.2	5.8	3.3	-0.6	2.5
China	10.5	9.6	8.8	7.8	7.1
Hong Kong, China	3.9	4.5	5.0	-5.3	3.1
Japan	1.5	5.1	1.6	-2.5	0.2
Korea	8.9	6.8	5.0	-5.8	10.7
Chinese Taipei	6.4	6.1	6.7	4.6	5.4
Southeast Asia	8.2	7.4	4.1	-6.3	4.0
Brunei Darussalam	3.0	1.0	3.6	-4.0	2.5
Indonesia	8.2	7.8	4.7	-13.1	0.3
Malaysia	9.8	10.0	7.3	-7.4	5.8
The Philippines	4.7	5.9	5.2	-0.6	3.3
Singapore	8.0	7.5	8.4	0.4	5.4
Thailand	8.9	5.9	-1.8	-10.4	4.2
Vietnam*	9.5	9.3	4.4	5.8	4.8
Oceania	4.3	3.9	3.6	4.4	4.6
Australia	4.4	4.0	3.9	5.2	4.4
New Zealand	4.0	3.2	2.0	-0.2	3.4
Papua New Guinea*	-3.6	3.5	-3.9	-3.8	4.2
Russia	-4.0	-3.4	0.9	-4.9	3.2
APEC	2.9	4.4	3.9	2.2	3.6

* Figures for 1995-96 were obtained from the 1999 APEC Report, while 1997-99 data is from *Asian Development Outlook (ADO) 2000*.

Sources: Individual Economy Reports.

The increase in goods and services production, and recovery of private consumption towards the last quarter of 1999 mainly contributed to the economic rebound. *Chile* was the only economy in the Latin American region that contracted in 1999. This was due to a combination of factors such as the Asian Financial Crisis, the El Niño weather phenomenon, and sharp drops in the prices of major export commodities.

Among the APEC member economies, *Korea* recorded the highest GDP growth at 10.7 percent in 1999, a dramatic turnaround from the –5.8 percent in 1998. This was fueled by robust growth in private consumption, especially in durable goods such as cars, mobile phones, personal computers and furniture. The fast-paced growth was backed by supportive macroeconomic policies which included a flexible monetary policy, to keep the core inflation rate within the targeted range, and a flexible exchange rate policy. The economy of *Hong Kong, China* had a similar rebound from the 5.3 percent contraction in 1998 to a 3.1 percent growth in 1999. This rebound was mainly driven by high export activities due to the resurgence of demand in East Asian markets, as well as sustained import absorption in the *United States* and *Europe*. *China* and *Chinese Taipei*, the two economies in the Northeast Asian region that were least affected by the financial crisis, continued to post respectable growth rates in 1999. The economy of *China* grew by 7.1 percent in 1999, albeit at a slightly slower pace compared to the 7.8 percent growth in 1998. Among the aggregate demand components, government consumption recorded the highest growth relative to private consumption, exports and investments. On the other hand, *Chinese Taipei* managed to grow by 5.4 percent in 1999 despite the strong earthquake that affected the economy in the latter part of 1999. The 0.8 percentage point increase in GDP was attributed to a resurgence in foreign demand and a pick-up in private consumption. Meanwhile, *Japan's* economy made a modest recovery by growing by 0.2 percent in 1999 compared to a 2.5 percent drop in output in 1998. Although personal consumption remained broadly flat, corporate profits continued to improve markedly, and investment in plant and equipment continued its upward trend. Japan's expansionary macroeconomic policies and the rebound in Asian economies contributed to this modest economic recovery.

Indonesia and *Thailand*, the two hardest hit Southeast Asian economies in 1998, have started to rebuild their troubled economies. The *Indonesian* economy, which contracted by 13.1 percent in 1998, recorded a marginal but positive growth of 0.3 percent in 1999. This was mainly driven by private consumption. *Thailand's* economy grew by 4.2 percent in 1999 compared to a 10.4 percent fall in GDP the previous year. This was due to increased demand boosted by several stimulus packages from the government and a rebound in the export sector. *Malaysia's* economy rebounded from a contraction of 7.5 percent in 1998 to record a strong positive growth of 5.8 percent in 1999. The expansion gathered momentum in the second half of 1999 when expansionary fiscal and accommodative monetary policies, as well as sustained buoyant external demand raised output growth. In the *Philippines*, increased government and personal consumption as well as exports supported the 3.3 percent output growth in 1999. Its top exports, namely semiconductors and electronics, grew by 8.1 percent in 1999. Meanwhile, *Viet Nam's* economic growth rate decelerated further in 1999, only registering 4.8 percent – the lowest in the last decade.

All told, the economic performance of crisis-hit Asian economies, that is, *Indonesia*, *Thailand*, *Philippines*, *Malaysia*, and *Korea*, has been considered noteworthy with positive growth recorded in all economies. Fiscal and monetary stimuli, as well as strong

global demand for electronic products, contributed to the rapid recovery in 1999 (IMF 2000).

The economies south of the Pacific experienced similar respectable growths in 1999 with *Australia* registering a 4.4 percent increase in 1999 compared to 5.2 percent in 1998. *New Zealand* reversed the 0.2 percent contraction in 1998 to a robust 3.4 percent growth rate in 1999. For both economies, growth was broad-based led by increased consumption expenditure and ongoing residential investment. They also benefited from the economic recovery in its neighboring economies. Significant improvement in the economic environment of *Papua New Guinea* occurred after the financial crisis and drought that hit the economy in 1998. After contracting by 3.8 percent in 1998 GDP dramatically grew by 4.2 percent in 1999 due to improved commodity prices and increased export volumes particularly in the mineral sector.

The *Russian* economy similarly has started to shake off the effects of the recent crisis. Output grew by 3.2 percent in 1999 against the 4.9 percent decline recorded in 1998. The growth was mainly due to increased investment and improved export performance.

Slow Increase in Prices¹

The world economy's inflation rate in 1999 was at its lowest in 40 years. For advanced economies, inflation for 1999 averaged 1.4 percent compared to 1.5 percent in 1998, developing economies recorded an average inflation rate of 4.3 percent last year against 5.3 in 1998, and economies in transition experienced an average growth in prices of 8.0 percent in 1999 compared to 10.0 percent in the previous year (IMF 1999). A general observation was that most member economies in the APEC region mirrored the worldwide experience of a deceleration in inflation (see Table 2).

The Latin American member economies were successful in curbing inflation. *Peru* recorded an inflation rate of 3.7 percent in 1999, the lowest since 1960 while the inflation rate in *Chile* continued its downtrend from 4.7 percent in 1998 to 2.3 percent in 1999. *Mexico's* inflation rate of 12.3 percent, albeit second highest in the APEC region, was a marked improvement over last year's 18.6 percent rate.

¹ Inflation is the annual rate of change in the consumer price index.

Table2
Consumer Price Index in the APEC Region
in Percent Change, %

	1995	1996	1997	1998	1999
Western Hemisphere	4.5	3.8	2.9	2.3	2.6
Canada	1.9	1.6	1.6	1.0	1.7
Chile	8.2	6.6	6.0	4.7	2.3
Mexico	52.0	27.7	15.7	18.6	12.3
Peru	10.2	11.8	6.5	6.0	3.7
The United States	2.8	2.9	2.3	1.6	2.2
Northeast Asia	2.3	1.8	2.2	0.9	-0.5
China	17.1	8.3	2.8	-0.8	-1.4
Hong Kong, China	9.1	6.3	5.8	2.8	-4.0
Japan	-0.1	0.1	1.8	0.6	-0.3
Korea	4.5	5.0	4.4	7.5	0.8
Chinese Taipei	3.7	3.1	0.9	1.7	0.2
Southeast Asia	6.3	5.5	6.4	21.8	2.3
Brunei Darussalam	6.0	2.0	1.7	-0.4	-0.1
Indonesia	8.6	6.5	11.1	77.6	2.0
Malaysia	3.4	3.5	2.7	5.3	2.8
The Philippines	8.0	9.1	6.0	9.8	6.6
Singapore	1.7	1.4	2.0	-0.3	0.0
Thailand	5.8	5.9	5.6	8.1	0.3
Vietnam*	12.7	4.5	3.6	9.2	0.1
Oceania	4.6	2.7	0.4	0.9	1.5
Australia	4.7	2.6	0.3	0.8	1.5
New Zealand	2.9	2.6	0.8	0.4	0.5
Papua New Guinea*	17.3	11.6	3.9	13.6	14.9
Russia	231.1	121.8	111.0	184.4	136.5
APEC	8.3	6.1	5.4	5.4	2.9

* Figures from the ADO 2000.

Sources: Individual Economy Reports.

Meanwhile, *Canada* experienced a slight upturn in its consumer price index (CPI), from 1.0 percent in 1998 to 1.7 percent in 1999. The *United States* likewise experienced a moderate acceleration in its CPI, from 1.6 percent in 1998 to 2.2 percent in 1999, largely due to the rise in energy prices.

Three Northeast Asian economies namely *Hong Kong, China; Japan; and China*, experienced a deflation in 1999. For *Hong Kong, China; and China*, the downtrend in consumer prices was a result of declining labor cost, relatively low rental cost and the continued freeze in government fees, and limited public utility charges. For *Japan*, the large decline in fresh food prices, previous yen appreciation, and the sluggishness of private consumption contributed to the decline in the consumer price index for 1999. Both *Korea* and *Chinese Taipei* were able to bring down the inflation rate to less than 1.0 percent in 1999.

Southeast Asian economies succeeded in stabilizing prices in 1999. *Malaysia* and *Thailand* were successful in curbing inflationary pressures whilst the *Philippines* posted a single-digit increase in prices at 6.6 percent in 1999, down from 9.8 percent the previous year. In *Indonesia*, price stability has been restored following the ill effects of the financial crisis. The inflation rate in 1999 dropped to 2.0 percent coming from a high of 77.6 percent in 1998. *Singapore* recorded a flat growth in consumer price index for 1999, reversing the 0.3 percent decline in the previous year while *Brunei Darussalam* has experienced a fall in consumer price index for two consecutive years. *Vietnam's* inflation rate sharply declined to 0.1 percent in 1999 from a high of 9.2 percent the previous year. This was mainly due to falling food prices, which account for about two-thirds of the CPI.

New Zealand and *Australia* likewise were able to ward off inflationary pressures. Favorable weather conditions improved agricultural production in *New Zealand*, thereby lowering fresh fruit and vegetable prices. This partly offset the inflationary pressures that stemmed from the rise in oil prices. In *Australia*, robust productivity growth, moderate wage increases, heightened competitive pressures and a rise in the value of the Australian dollar all contributed to an exceptionally good inflation performance in 1999. In *Papua New Guinea*, prices continue to rise due to the depreciation of the kina. The inflation rate in 1999 reached a high of 14.9 percent, 1.3 percentage points higher than the previous year.

The lower inflation rate phenomenon shared by most member-economies and the rest of the world partly reflects an emerging global consensus among monetary authorities to focus on a low inflation goal. Indeed, there is now a trend in the APEC region towards inflation targeting. Other factors that could have contributed to the general convergence toward price stability include trade liberalization, deregulation of selected sectors, privatization movements and the hesitance of governments to bail out uncompetitive firms (IMF 1999).

Labor Opportunities Diverse in the Region

The *US* labor market experienced robust growth in 1999 associated mainly with the strong and sustained output demand. Approximately 2.5 million private/business sector non-farm jobs were created, and the unemployment rate dipped to 4.2 percent—the lowest since 1969 (see Table 3). *Canada's* unemployment rate also declined from 8.3 percent in 1998 to 7.6 percent in 1999 and it experienced its lowest level of unemployment in 24 years.

The labor market conditions in Latin American member-economies vary. In *Mexico*, unemployment rate slightly fell from 2.8 percent in 1998 to 2.5 percent in 1999. The continued expansion in the Mexican economy partly contributed to the decline in the unemployment rate. *Peru's* unemployment rate also fell slightly from 7.8 percent in 1998 to 7.7 percent. In contrast, *Chile* experienced a hefty rise in unemployment rate from 6.2 percent in 1998 to 9.7 percent in 1999.

Table 3
Unemployment Rates in the APEC Region
in Percent Change, %

	1995	1996	1997	1998	1999
Western Hemisphere					
Canada	9.4	9.6	9.1	8.3	7.6
Chile	7.4	6.5	6.1	6.2	9.7
Mexico	6.3	5.5	3.2	2.8	2.5
Peru*	n.a.	7.0	7.7	7.8	7.7
The United States	5.6	5.4	4.9	4.5	4.2
Northeast Asia					
China	2.9	3.0	3.1	3.1	3.1
Hong Kong, China	3.2	2.8	2.2	4.7	6.3
Japan	3.2	3.4	3.4	4.1	4.7
Korea	2.0	2.0	2.6	6.8	6.3
Chinese Taipei	1.8	2.6	2.7	2.7	2.9
Southeast Asia					
Brunei Darussalam	4.9	3.9	4.2	4.7	4.6
Indonesia	7.2	4.9	4.8	5.5	6.4
Malaysia	3.1	2.5	2.4	3.2	3.0
The Philippines	9.5	8.6	8.7	10.1	9.7
Singapore	2.0	2.0	1.8	3.2	3.5
Thailand	1.7	1.5	1.5	4.4	4.2
Vietnam*	n.a.	n.a.	n.a.	6.6	7.4
Oceania					
Australia	8.5	8.5	8.5	8.0	7.2
New Zealand	6.3	6.1	6.6	7.7	6.3
Papua New Guinea	n.a.	n.a.	n.a.	n.a.	n.a.
Russia					
	9.0	10.0	11.2	13.3	13.3
APEC					
	0.5	0.6	0.7	0.8	1.0

* Unemployment in the urban areas.

n.a. - not available

Sources: Individual Economy Reports.

The unemployment rate in the Northeast Asian region overall increased slightly in 1999 with *Hong Kong, China* showing the largest change in its unemployment rate. From 4.7 percent in 1998, *Hong Kong, China's* unemployment rate increased by 1.6 percentage points in 1999. But there was a sharp turnaround in 2000, with total employment growing by about 1.7–1.9 percent in the first two quarters. *Korea* continued to experience a high unemployment rate with 6.3 percent in 1999, but this was better than the 6.8 unemployment growth recorded in the previous year. Employment figures for the first eight months of 2000 suggest that unemployment rate has continued to fall. Meanwhile, the unemployment rate in *Japan* rose from 4.1 percent in 1998 to 4.7 percent in 1999 due to the prolonged economic slump.

China's unemployment rate has remained at 3.1 percent for three consecutive years. The reemployment program that started in 1998 made headway in 1999 by re-employing 4.9 million workers from the 5.6 million staff laid off from state-owned enterprises. On the other hand, *Chinese Taipei* had a slight increase in its unemployment rate which reached 2.9 percent, the highest since 1967.

The *Philippines* continued to record the highest unemployment rate in the Southeast Asian region with 9.7 percent in 1999. Still, this was an improvement over the double-digit unemployment rate of 10.1 percent recorded in 1998. *Singapore* experienced a very slight increase in its unemployment rate in 1999. For Singapore, the increase, from 3.2 to 3.5 percent, was mainly due to continual restructuring and consolidation in certain key manufacturing segments, particularly in the disk drive subsector. *Thailand* and *Malaysia* had a slight improvement in their unemployment rates. In *Thailand* this was due to public programs that boosted temporary employment and the agriculture sector which absorbed the laid-off urban workers.

Falling unemployment rates can be observed both in *Australia and New Zealand* in 1999 relative to the previous year. Sustained, strong growth in domestic demand continued to underpin ongoing employment growth and falling unemployment in these economies.

In Russia, the unemployment rate has remained high at 13.3 percent for two consecutive years.

External Sector Performance: Reversed

Economies in the Northeast and Southeast Asian region experienced a current account surplus in 1999 in contrast with the current account deficit in the economies in the Western Hemisphere and Oceania region (see Table 4).

The current account deficit in the *US* amounted to US\$339 billion in 1999 approximately 3.7 percent of GDP compared to the previous year's deficit of 2.5 percent. Exports grew by 3.8 percent but were outweighed by imports resulting in a larger deficit. In contrast, the current account deficit in *Canada* narrowed to US\$3.4 billion or 0.4 percent of GDP. The marked reduction in the deficit was mainly due to the increase in merchandise trade surplus from \$19.1 billion in 1998 to \$33.8 billion in 1999.

The Latin American member economies showed an improvement in their current account positions. In *Chile*, the current account deficit declined from 5.7 percent of GDP in 1998 to 0.1 percent of GDP in 1999. This was due to the contraction of imports alongside the

expansion of exports. *Peru* similarly recorded a smaller current account deficit caused by a US\$1,865 million fall in the trade deficit. The increase in traditional exports, such as mining and fishing exports, as well as non-traditional exports contributed to the narrowing of the trade deficit. On the other hand, imports experienced a downtrend due to lower domestic activity.

Table 4
Current Account Balance
as a Percentage of GDP, %

	1995	1996	1997	1998	1999
Western Hemisphere					
Canada	-0.8	0.6	-1.6	-1.8	-0.4
Chile	-2.1	-5.1	-5.0	-5.7	-0.1
Mexico	-0.6	-0.7	-1.9	-3.7	-2.9
Peru	-7.7	-6.2	-5.2	-6.4	-3.5
The United States	-1.5	-1.7	-1.7	-2.5	-3.7
Northeast Asia					
China	0.2	0.9	3.3	3.0	1.58
Hong Kong, China	n.a.	n.a.	-3.6	2.4	6.6
Japan	2.1	1.4	2.2	3.2	2.5
Korea	-2.0	-4.4	-1.7	12.5	6.3
Chinese Taipei	2.1	3.9	2.4	1.4	2.0
Southeast Asia					
Brunei Darussalam	47.4	52.1	49.0	43.3	46.2
Indonesia	-3.4	-3.5	-3.0	4.3	4.1
Malaysia	-10.2	-4.6	-5.9	13.7	17.1
The Philippines	-4.4	-4.8	-5.3	2.4	9.5
Singapore	17.3	15.2	17.9	25.4	25.0
Thailand	-7.8	-7.9	-2.1	13.3	9.1
Vietnam*	-11.0	-10.3	-6.5	-4.3	4.0
Oceania					
Australia	-5.4	-3.9	-3.1	-5.0	-5.7
New Zealand	-5.0	-6.2	-6.8	-4.2	-6.7
Papua New Guinea*	13.6	5.9	-5.0	0.5	1.4
Russia					
	2.4	3.0	0.6	0.4	13.5

* Figures for 1995-96 were obtained from the 1999 APEC Report, while 1997-99 data were from ADO 2000 Update.

Sources: Individual Economy Reports.

Thus, current account deficit, as a percentage of GDP, stood at 3.5 percent in 1999, an improved situation over the 6.4 percent in 1998. For *Mexico*, the current account deficit in 1999 shrank to US\$14.0 billion, equivalent to 2.9 percent of GDP. Strong domestic demand spurred import activity, with imports of consumer goods increasing by 9.6 percent and imports of capital goods similarly increasing by 18.5 percent. However, non-petroleum exports rose by 14.9 percent. With the rise in oil prices, the value of Mexican oil exports increased by more than 39 percent in 1999, partly contributing to the decline in the current account deficit.

In Northeast Asia, all the economies continued to post current account surpluses in 1999. Because of a much reduced visible trade deficit and a marked increase in invisible trade surplus amidst the recovery in regional demand, the current account position of *Hong Kong, China* improved from 2.4 percent in 1998 to 6.6 percent in 1999.

China's current account balance as a percentage of GDP was posted at 1.58 percent, down from 3.0 percent registered in the previous year. The declining trend in export growth that occurred in the first half of 1999 was reversed in the second half of the same year. This growth momentum continued through the first half of 2000, with exports surging by 38.3 percent. *Japan* likewise experienced a decline in the ratio of current account to GDP. With growth in real imports outpacing growth in real exports, *Japan's* current account surplus narrowed to 2.5 percent of GDP in 1999 compared to 3.2 percent registered in 1998. *Korea's* current account surplus in 1999 narrowed to 6.3 percent of GDP as imports surged given strong domestic demand. For *Chinese Taipei*, there was an improvement in the current account balance mainly due to the sharp increase in the trade surplus. Its two-way trade has returned to its 1997 pre-crisis level with exports to Japan and the ASEAN economies growing in double-digit levels. In 1999, the current account surplus stood at 2.0 percent of GDP, 0.6 percentage points higher than the previous year.

In Southeast Asia, all the economies realized positive current account balances in 1999. *Brunei Darussalam* continues to enjoy a comfortable external position mainly due to hydrocarbon exports and the steady accumulation of income from their long-term investment abroad. The trade surplus significantly improved due to an increase in the production and prices of oil and gas. This resulted in the current account surplus reaching 46.2 percent of GDP in 1999 *vis-à-vis* 43.3 percent in 1998. *Malaysia* and *Singapore* both experienced a healthy trade balance mainly due to the strong global demand for electronics, chemicals, and telecommunications. *Malaysia's* current account surplus registered at 17.1 percent of GDP in 1999, while that of *Singapore* stood at 25.0 percent.

Indonesia and *Thailand* both experienced a fall in their current account surpluses. In *Indonesia*, despite improving in dollar terms, the current account surplus as a percentage of GDP slightly fell from 4.3 percent in 1998 to 4.1 percent in 1999. This occurred in spite of the higher prices for exports of oil/gas during the year. The current account surplus continued through the first semester of 2000 due to higher oil prices and strong growth of non-oil/gas exports such as electronics, textiles, wood and paper products. *Thailand's* current account surplus fell from 12.7 percent of GDP in 1998, to 9.1 percent in 1999. Import growth outpaced export growth, resulting in the decline of the trade surplus.

In the *Philippines*, the current account surplus ballooned from US\$1.5 billion in 1998 to US\$7.2 billion in 1999. As a percentage of GDP, it climbed from 2.4 percent in 1998 to

9.5 percent in 1999. Merchandise exports outgrew imports by about 15 percentage points. The bulk of exports consisted of electrical and electronic equipment, followed by machinery and transport equipment. Similarly, service trade receipts exceeded payments by US\$2 billion in 1999, contributing to the *Philippines'* improvement in the current account balance.

New Zealand's exports grew by 8 percent in 1999, the strongest growth rate since the mid-1990s. However, the oil price increase, sturdy demand for imports in light of a buoyant domestic economy, and the importation of the ANZAC frigate were partly responsible for imports outpacing exports. Thus, the current account deficit widened to 6.7 percent of GDP in 1999, from 4.2 percent in 1998. In *Australia*, the current account deficit increased from 5.0 percent of GDP in 1998 to 5.7 percent in 1999. Its manufacturing and services exports were adversely affected by reduced demand from Asian regions. However, although Australia's commodity exporters were also adversely affected by lower demand in Asia, this was mitigated by their ability to redirect commodity exports to other world markets. This situation appeared to have changed as East Asian economies started to recover in 1999. The current account position of *Papua New Guinea* continued to post remarkable improvement. From a deficit in 1997, it recorded a surplus in 1998 and 1999. As a percentage of GDP, the current account surplus was 1.4 percent in 1999 against 0.5 percent in 1998. This was made possible due to higher oil prices enabling the economy to record a trade surplus reaching \$269 million.

Prospects²

The world economy is expected to strengthen further with GDP estimated to increase by 4.7 percent in 2000 and 4.2 percent in 2001 (IMF 2000). The principal factors that will propel the growth of the world economy are (1) the continuing and unexpectedly strong economic performance of the US, (2) expansion in Europe, (3) the gradual yet fragile recovery of Japan, and (4) a sustained recovery of crisis-affected Asian economies. Similarly, the IMF and the Asian Development Bank (ADB) projected that practically all APEC member economies will sustain the recovery they gained in 1999, and post significant GDP growth in 2000 and 2001 (see Table 5).

² Forecast figures are official estimates unless otherwise stated.

Table 5
GDP Growth Forecasts
in Percent Change, %

	Official		IMF	
	2000	2001	2000	2001
Western Hemisphere	4.7	---	5.2	3.3
Canada	4.0	n.a.	4.7	2.8
Chile	5.9	6.2	6.0	6.8
Mexico	4.5	5.0	6.5	4.8
Peru	4.0-5.0	4.0-5.0	4.0	6.0
The United States	4.8	3.2	5.2	3.2
Northeast Asia	3.1	---	3.6	3.5
China	7.0	8.0	7.5	7.3
Hong Kong, China	8.5	4.0	8.0	4.8
Japan	1.0	n.a.	1.4	1.8
Korea	8.5	n.a.	8.8	6.5
Chinese Taipei	6.6	6.5	6.5	6.0
Southeast Asia	5.8	---	6.0	6.0
Brunei Darussalam	3.0-3.5	n.a.	n.a.	n.a.
Indonesia	3.0-4.0	4.5	4.0	5.0
Malaysia	5.8	n.a.	6.1	6.0
The Philippines	4.0	4.0-4.5	4.0	4.5
Singapore	9.0	5.0-7.0	7.9	5.9
Thailand	4.5-5.5	n.a.	5.0	5.0
Vietnam	6.0-7.0	7.0	4.5	5.4
Oceania	4.5	---	4.3	3.6
Australia	4.3	3.8	4.0	3.4
New Zealand	4.1	2.8	4.0	3.2
Papua New Guinea*	3.4	2.7	3.4	2.7
Russia	5.5	n.a.	7.0	4.0

*Figures for PNG are from ADO 2000 Update.

Note: The midpoint was used for economies whose forecasts are in ranges.

Sources: Individual Economy Reports.
IMF 2000, ADO 2000.

The robust performance of the *US* economy in the first half of 2000 has been attributed mainly to labor productivity gains arising from the technology-driven “new economy”. Labor productivity in the *US* rose to 4.0 percent for the decade 1990–99—a marked improvement compared to 2.9 percent for 1980–89, and 2.5 percent for 1970–79. The rise of the new economy partly influenced the strong performance of the *US* economy, resulting in 5.3 and 6.0 percent GDP growth for the first two quarters of 2000 respectively. Consequently, *US* growth projections for 2000 and 2001 have been revised upwards reflecting the productivity effects of technology-driven industry. Based on the latest IMF forecasts, the *US* economy will grow by 5.2 percent in 2000, before slowing down to 3.2 percent in 2001. Initially, several economists predicted a *US* slowdown in 2000. But due to the robust performance in the first half of the year, the predicted slowdown has been “postponed” to 2001. Moreover, the effects of the new economy positively influenced the values of technology stocks in the 1990s, increasing the share of the technology stocks in total market capitalization from 18 percent in 1990, to 33 percent in 1999. This, together with the general increase in equity prices, created a strong wealth effect, which in turn spurred consumption demand (ADB 2000).

Canada’s near-term economic prospects remain solid. Output will likely remain healthy with GDP forecast to grow by 4 percent in 2000. The IMF projects an even higher growth of 4.7 percent for *Canada* for the year 2000, with a gradual slowdown of 2.8 percent growth in 2001 attributed to a tightening of monetary policy and the anticipated slowdown of the *US* economy. Booming exports and increasing fixed investment are the identified drivers of growth. The inflation rates for 2000 and 2001 are expected to stay within the inflation target band of 1.0 to 3.0 percent set jointly by the government and the Bank of *Canada*. The unemployment rate, which improved in the first quarter of 2000, is projected to decline further through 2001.

The Latin American economies are similarly expecting positive economic growth in 2000, with *Mexico* and *Chile* expected to exhibit a more rapid growth trend. The expected growth in the Latin American economies will be fueled by buoyant exports and a recovery in consumer confidence. *Peru’s* economy is projected to expand by 4 to 5 percent in 2000, following the completion of the first year of its Extended Fund Facility with the IMF, and by about the same in 2001. The government is targeting an inflation rate of 3.5–4.0 percent for 2000. The passage of the Fiscal Responsibility and Transparency Law was a significant measure adopted by the Peruvian government in 1999. One of the provisions of the said law sets a limit to the fiscal deficit to 2 percent of GDP in 2000, 1.5 percent in 2001 and 1 percent thereafter. The *Mexican* economy is expected to benefit from the stronger growth of the global economy in general and the *US* economy in particular. The economy is forecast to grow by 4.5 percent in 2000, supported by an increase in gross fixed investment and sustained non-oil export growth, and by 5.0 percent in 2001. After contracting in 1999, *Chile’s* economy is projected to post a robust growth of 5.9 percent in 2000 and 6.2 percent in 2001. It is benefiting from the increased global activity, a turnaround in primary commodity prices, and the relatively low domestic interest rate. However, inflation is expected to inch up in 2000 as a result of the recovery of the domestic economy and increases in the international prices of oil.

There are clear indications that the economic recovery in crisis-hit Asian economies can be sustained in the short-term period, as the Asian crisis appears to have fully run its course. On the demand side, the persistence of a buoyant export sector fueled by strong global demand for electronics and communications goods seems to be the key driver for

most recovering economies in year 2000. Trade volumes for most economies are expected to remain strong for the rest of the year. Moreover, there are strong indications that domestic demand has begun to pickup in crisis-hit Asian economies, eventually making this component of aggregate demand a major source of growth for these economies.

In Northeast Asia, *Japan* is showing signs of a recovery. Investment spending increased, partly due to the growing optimism among large business enterprises. The consensus of private forecasters for fiscal year 2000 GDP growth was revised from 1.0 percent at the end of 1999 to 2.2 percent in September 2000. Prospects for *Japan* depend crucially on significant improvement in private/business sector investment and healthy consumption demand. However, there remain some risks in these factors. The level of corporate debt compared to cash flow is still higher than the level at the beginning of the previous recession phase, particularly in the small and medium-sized enterprises (SME) sector. The number of bankruptcies, which had fallen until the beginning of 1999, began to rise again in 2000. Furthermore, the employment conditions diffusion index (DI) in the Bank of Japan's Tankan survey shows that excessive employment remains, suggesting the persistently severe conditions of employment. The uncertainty over future income prospects of workers may be hampering the recovery of private consumption.

The first two quarters of 2000 saw *Korea's* economy rapidly growing by 12.8 percent and 9.6 percent, respectively. Thus, the latest revised forecast for GDP growth in 2000 is placed at 8.5 percent. Strong growth in domestic demand, such as private consumption and equipment investment, as well as exports, particularly electronics, will be the main drivers of the economy's growth. The IMF forecasts a higher growth of 8.8 percent for *Korea* in 2000 but with a slow-down in 2001. The unemployment rate is expected to decline in 2000 as the economy continues to expand. However, the inflation rate has already started to inch up in the last few months. The Korean Central Bank plans to keep the inflation rate within the 1.5 to 3.5 percent range in 2000.

For *Chinese Taipei*, most of the efforts will still be channeled to reconstructing the economy in the aftermath of the strong earthquake that hit the region in September 1999. The reconstruction, together with the implementation of the high-speed railway project, is expected to boost domestic demand. Exports will likely remain strong as the Asian Financial Crisis continues to recede and the local electronic industries continue to gain competitiveness in the world market. The economy grew by 6.7 percent in the first half of 2000 and is expected to post a 6.6 percent growth for the whole year. The IMF predicts a 6.5 percent growth of GDP in 2000, and a marginal drop to 6.0 percent in 2001. Meanwhile, *Hong Kong, China*, has fully recovered from the setback brought about by the Asian Financial Crisis. Adjustment in the internal cost/price structure has enabled the economy to quickly restore its competitiveness. The economy of *Hong Kong, China*, showed a broad-based upturn during the first half of 2000 as both exports and domestic demand surged. Because of this, the unemployment rate has begun to decline. For the whole of 2000, GDP is projected to grow by 8.5 percent. In the medium-term, the economy is forecast to grow by 4 percent per annum.

For *China*, the process of economic reform and development is expected to continue for the year 2000, focusing on state-owned enterprise reform, economic restructuring, technological advancement and enlargement of domestic demand. Moreover, its accession to the World Trade Organization (WTO) is expected to bring challenges and benefits to the growing economy (IMF 2000). *China* is expected to continue growing at a robust pace

supported by stronger private consumption and exports. The economy is projected to grow by 7 percent in 2000 and to accelerate further by 8 percent in 2001. The IMF predicts that China will achieve a growth rate of 7.5 percent in 2000 and 7.3 percent in 2001. After declining for two consecutive years, the CPI is forecast to increase marginally in 2000 and by 3.5 percent in 2001.

The export-led recovery of Asian economies, especially in the Southeast Asian region, resulted in a stronger current account position. For *Indonesia*, the GDP growth rates for the first half of 2000 suggest that economic recovery is gaining greater momentum in line with improvements in oil and non-oil exports and investment. The economy is projected to grow better than the 3 to 4 percent projected range in 2000 and is expected to accelerate further in 2001. The IMF forecasts a 4 percent growth in 2000 and 5.0 percent in 2001. The inflation rate was 2.86 percent for the first half of 2000 and is targeted to range between 3 and 5 percent for the whole year. However, the actual inflation rate is expected to exceed the target, given the continued depreciation of the rupiah. For 2001, inflation is projected to accelerate further to 7.2 percent. Similarly, *Viet Nam* expects to strengthen its growth momentum through exports, particularly garments, textiles and footwear commodities. GDP is projected to increase by 6.0–7.0 percent in 2000 and by about 7.0 percent in 2001.

One of the economies with a notable improvement is *Malaysia* whose 2000 GDP forecast has been upgraded consistently due to the robust performance of both the manufacturing and services sectors in the first two quarters. Private/business sector investment and consumption are expected to be the main drivers of growth, supported by a robust export sector. The *Malaysian* economy is forecast to sustain the recovery and post a positive GDP growth of 5.8 percent for the year 2000. The IMF is more upbeat, predicting the economy to grow by 6.1 percent in 2000 and 6.0 percent in 2001. Similarly, the outlook for *Singapore* remains bright as suggested by forward-looking indicators such as the composite leading index and business expectations. The continued strong growth in the US economy, gradual recovery of the Japanese economy and better-than-expected recovery of the crisis-hit Asian economies all provide a favorable external environment to Singapore's economy. Overall, the economy is projected to grow by 9.0 percent in 2000. The IMF is predicting a 5.9 percent growth in 2001. Prices are expected to remain stable, with inflation rate ranging from 1.0 to 2.0 percent in 2000. The IMF predicts inflation rate to rise slightly to 2.1 percent in 2001.

For the *Philippines*, growth indicators showed positive signs in the first half of 2000, indicating that the economic recovery will likely be sustained for the rest of this year and 2001. The growth target for 2000 is between 4.0 and 5.0 percent, supported by a robust growth in merchandise exports, recovery of household expenditure and expansion of the productive sectors of the economy. Growth is expected to accelerate further in 2001, ranging from 5.5 to 6.5 percent. The first half of 2000 saw the inflation rate continuing its downward trend. Thus, the inflation rate for the entire year is expected to fall short of the targeted inflation rate of 6.0 to 7.0 percent. The labor market condition is expected to remain tight as indicated by the slight upturn in the unemployment rate in the first half of 2000. In *Thailand*, recovery is more pronounced as evidenced by the declining ratio of non-performing loans in the banking sector, and the restructuring of a significant portion of its problem debt. Growth is expected to be more broad-based with exports, public expenditures, private consumption and investment simultaneously coordinated to achieve a 4.5-5.5 percent growth target for the year 2000.

The oil-rich economy of *Brunei Darussalam* is projected to grow between 3.0 and 3.5 percent in the year 2000. In contrast to the deflationary situation of the past two years, the CPI is expected to rise by 1.0 percent in 2000. Among the important factors that could affect the medium-term outlook of the economy are the production, and price levels of the oil and gas exports and the exchange rate.

The *Australian* economy will likely experience solid growth and low inflation for the year 2000, albeit with a slight slowdown in GDP growth. Domestic demand is expected to grow at a more moderate pace than in recent years while stronger business investment and a strengthened export sector will partly offset the lower domestic consumption. The economy is projected to expand by 4.3 percent in 2000 and 3.8 percent in 2001. Growth in employment will remain strong at 2.8 percent and 2.3 percent in 2000 and 2001, respectively. The inflation rate is forecast to rise slightly to 2.5 percent in 2000, reflecting the impact of higher world oil prices in 1999 and in the early months of 2000. Similarly, *New Zealand* is expected to slow down from the strong growth rates seen in the latter half of 1999. Inflationary pressures are likely to be stronger in 2000 as result of the weaker NZ dollar and the sharp rise in the cost of crude oil. Following the annual average growth of 4.1 percent in 2000, growth in the economy is expected to slowdown to 2.8 percent in 2001. The export sector is expected to be the major driver of growth over this period.

The *Russian* economy is expected to grow by 5.5 percent in year 2000, although the IMF projects a much higher growth of 7.0 percent in 2000, before falling 4.0 percent in 2001. The government's main pre-occupation is the improvement of real incomes against a backdrop of lower inflation and efforts aimed at the development of the market and institutional infrastructure. The buoyant growth of *Russia* is expected to come from strengthening investment and non-oil exports, supported by increased consumption. The inflation rate for 2000 is predicted to reach 20 percent.

While it is expected that most APEC member economies will record positive growth in 2000 and 2001, a large part of that growth depends on stronger global demand, as influenced by the US economy, and a gradual but sustained rebound for the Japanese economy. It is important to identify some risk factors that could possibly hinder the progress of economic recovery in the APEC region. One factor is the development of the US economy in the next few years. According to the ADB (2000), there are signs of a slowing down in domestic demand growth in the US economy, with the possibility of a hard landing in 2001. If there is a steep drop in US import demand, the ongoing recovery in other APEC member economies might be derailed. However, the IMF (2000) projects that the negative impact of a hard landing for the US economy would be largest for Latin America and less for Asia given its stronger external position.

Another risk factor is the continued volatility in the financial markets in the Asian region that could affect availability of capital (ADB 2000). Table 6 shows that from January to August 2000, stock prices of the five East Asian economies declined by between 11 percent and 34 percent, while the currencies of Indonesia, the Philippines, and Thailand depreciated by 12.66 percent, 10.0 percent and 8.0 percent, respectively. Still another threat emanates from the likelihood of a further rise in oil prices, which would create additional inflationary pressures. This might further erode the purchasing power of most APEC member economies, affecting consumption spending, especially towards the last quarter of 2000 and 2001.

Table 6
Foreign Exchange Rate and Stock Price Index
Percent change from January to August 2000

Economy	Foreign Exchange	Stock Price Index
Indonesia	-12.26	-26.71
Korea	1.35	-15.50
Malaysia	0.00	-10.83
The Philippines	-9.88	-28.68
Thailand	-8.04	-33.88

Note: The change in stock price index of Korea is based on January and July 2000 figures.

Source: Asia Recovery Information Center

The recent oil price shocks have been worrisome to many economies not only within the Asia-Pacific region, but also outside. Their likely downside effects on the world economic outlook have not been lost on the IMF and the World Bank. In their Joint Ministerial Statement dated 10 September 2000, APEC Finance Ministers expressed the following:

“We note the risks posed by oil price volatility to the world economic recovery and for developing economies that are heavily dependent on oil market conditions, and the need to stabilize prices at sustainable levels. In the light of rising world demand, we call for appropriate increases in supplies and other necessary measures to promote long term price stability in the mutual interest of consumers and producers.”

Similar concerns were expressed by the Ministers of the Intergovernmental Group of Twenty-Four on International Monetary Affairs after their meeting in Prague, Czech Republic, on 23 September 2000. The Managing Director of the International Monetary Fund, Horst Kohler, in his concluding remarks at the closing joint session of the IMF – WB Annual Meeting in Prague, Czech Republic on 27 September 2000 stated:

“... we examined the risks to the sustainability of the global economic expansion, particularly the imbalances among the economies and currencies of the largest industrial countries and the situation in world oil markets. There was a common understanding that the current level of world oil prices is not in the interest of either oil-consuming countries or of oil producers. High oil prices are particularly harmful for the poorest countries. There was also broad interest in a producer-consumer dialogue aimed at promoting greater stability in oil markets....”

The IMF (2000) estimated that a \$5/barrel increase in oil prices raises the cost of net oil imports by advanced economies by about \$40 billion annually. The aggregate impact on other developing economy regions—a mix of oil exporters and importers—would be small but many individual developing economies would be severely affected, with trade balances deteriorating by more than ½ percent point of GDP. Higher oil prices would also have a direct impact on global output and inflation. Estimates by the IMF suggest that a \$5/barrel increase would reduce GDP growth in industrial economies by 0.2 percentage points in 2001 accompanied by a higher inflation (0.2- to 0.4 percentage points) and interest rates. Among the developing economy regions, output in Asia, which is relatively dependent on imported oil, would decline by 0.4 percent while there would little net

impact on Africa and the Western Hemisphere, a mix of oil importers and producers. However, the impact on some individual economies could be significantly more serious.

The conclusion of the World Bank and IMF regarding the possible impact of the oil price hike is not entirely new. The world economy already experienced two oil shocks in the past—the first in 1974-75, and the second in 1979-81. In the first oil shock, oil price rose from \$1.88/barrel in 1972 to \$9.52/barrel in 1974. For the oil exporters, there was an immediate effect in their trade balances. In contrast, the oil importers felt the effect a year later with GDP falling and inflation rising. As the world economy slowly adjusted to the shock, another round of oil price hike occurred. Starting at \$12.70/barrel in 1978, it increased to \$17.27/barrel in 1979, and further ballooned to \$28.18/barrel in 1980. The consequence of the second oil shock was fully apparent in 1980 with GDP growth falling in most OECD countries, and even an output contraction for economies like UK and US. Moreover, average inflation rate was pushed into double-digit range (ADB 1983).

As in the case of previous oil shocks, oil-exporting economies will find themselves with huge amounts of idle funds owing to increased revenue from oil. The challenge that the international financial market will face in the next two years is how to recycle these funds in a manner that recipients of such funds will use them in more productive investment. Economies that have already substantially liberalized and deepened their capital markets will definitely be in a better position to do it.

1.2 Policy Responses in Crisis-hit and Developed Economies

For many of the Asian economies that were in the eye of the 1997 Asian Financial Crisis, severe liquidity constraints prodded them to seek the help of the International Monetary Fund. In response, the IMF arranged credit arrangements for *Indonesia*, *Korea* and *Thailand*. Measures that were taken included economic stabilization, mobilization of financial support for the distressed economies from creditor banks, and policy advice supportive of structural reforms. The *Philippines* had arranged an exit program with the IMF before the Asian crisis struck. Meanwhile, *Malaysia* imposed capital controls in order to gain some policy leverage needed to counter the contractionary effects of the crisis.

The key elements in the stabilization program included (IMF 1999):

- temporary tightening of monetary policy to stem exchange rate depreciation;
- concerted action to correct weaknesses in the financial system;
- structural reforms to remove impediments to growth (such as monopolies, trade barriers, and unsound corporate practices) and to secure efficient financial intermediation, and ensure the long-term viability of financial systems;
- assistance in reopening or maintaining lines of external financing; and
- maintenance of responsible fiscal policy, involving budgetary provisions for the costs of financial restructuring, and protecting social spending.

The original stabilization programs in the various affected economies have been recalibrated in light of the observed recoveries. Deficit financing of government purchases took place. Many of the crisis-affected economies incurred fiscal deficits that are high by historical standards. In addition, monetary policy was relaxed to allow interest rates to decline. In most of the affected economies, however, the stock of private/business sector credit has not responded to this stimulus. One reason is that non-performing loans (NPLs) have reduced the stock as they have been removed from the balance sheets of banks and

converted into other instruments. Another is that investor and consumer confidence has not been fully restored in these economies and hence demand for credit is still weak.

In terms of structural reforms the main thrust was financial and corporate restructuring. In all cases, the policy measures in the financial sector aimed at:

- closure of unviable financial institutions with the associated write down of shareholders' capital;
 - recapitalization of undercapitalized institutions;
 - closer supervision of weak institutions; and
 - increased opportunities for foreign participation in domestic financial systems.
- Economies differed in their approach to the implementation of these policies (World Bank 2000). *Indonesia*, *Malaysia* and *Korea* have chosen a government-led approach to the restructuring of the banking sector, while *Thailand* has opted for a more market-oriented approach. In several cases, the government took the important first steps. The usual procedure is for the government to set up an asset management company, responsible for disposing of the assets of non-performing loans.

In the case of corporate restructuring, a decentralized approach has been followed. The standard role of government is to lay down the framework for possible voluntary resolution of past-due payments. The *Korean* government had to adopt a more active role, however, because of the involvement of the *chaebols* in the crisis.

Many observers consider the pace of banking and corporate restructuring as rather slow, especially with regard to the latter (e.g., Kawai 2000, Rana 2000). One reason is that bankruptcy laws are either outdated or non-existent in some of these economies. Also, there is a lack of jurisprudence due to absence of cases brought to court for resolution. The absence of institutionalized deposit insurance systems may have also contributed to a slower pace of banking and corporate restructuring. The overall depth of the crisis, however, has been the primary reason for the slow pace of restructuring. Tables 7 and 8 provide a glimpse on the progress in the five economies hardest hit by the crisis.

The policy response of the *US* during the time of the crisis tended to support the emergence of quick recoveries in the affected economies. The turbulence in financial markets and abrupt deterioration in the outlook for foreign growth prompted three easing moves by the Federal Reserve Board, from the end of September 1998 through mid-November of that year. This was done in recognition of the rising risk spreads and lower liquidity in the securities market, and that correction in the equity markets had, in effect, tightened overall financial conditions, requiring an easing simply to maintain the same degree of tightness or stimulus (Meyer 1999). However, this policy was reversed starting July 1999 as the Federal Reserve Board saw the need to keep inflation from accelerating and engineer a soft landing for the *US* economy, which will benefit other APEC member economies especially those that are currently recovering from the Asian crisis. Presently, the short-term *US* interest rates are 175 basis points higher than in November 1998.

Meanwhile, *Japan* was disbursing official development assistance through the Miyazawa initiative and the Obuchi fund.

**Table 7
Restructuring the Corporate Sector: Hardest Hit Asian Economies**

Economy	Basic Approach	Asset Management Company	Progress	Remarks
Indonesia	Private-sector involvement	Indonesian Debt Restructuring Agency (INDRA)	Indebted companies reorganize and restructure their organizations, while creditors reschedule loans and/or accept debt to equity conversion. Only 2% of the registered. 331 cases have been resolved as of March 2000.	The foreign currency terms set by INDRA did not appeal to corporations. The terms were later revised to reflect market conditions.
Korea	Government-led	Corporate Restructuring Coordination Committee (CRCC)	Substantial progress in restructuring four of the five largest <i>chaebols</i> with debt-equity ratio falling below the targeted level of 2.0 by the end of 1999.	The four conglomerates also outperformed the agreed targets in terms of asset divestiture and capital infusions.
Malaysia	Government-led with market framework	Corporate Debt Restructuring Committee (CDRC)	Debt resolution was significant with nearly 75 applications received, settled mainly through voluntary agreements. About 37.3% of the total cases were resolved.	The CDRC set various rules to guide restructuring but no penalties were imposed for non-compliance.
The Philippines				No specific new measures were undertaken to address the crisis.
Thailand	Market-led	Corporate Debt Restructuring Advisory Committee (CDRAC)	Debt settlements picked-up with an estimated 14% of total corporate debt restructured.	Legal and regulatory framework for corporations has improved. However, it may take some time before reforms can be fully implemented.

Source: Asia Recovery Report 2000.

Table 8				
Restructuring the Banking Sector: Hardest Hit Asian Economies				
Economy	Basic Approach	Asset Management Company	Progress	Remarks
Indonesia	Government-led	Indonesian Bank Restructuring Authority (IBRA)	Accdg. To Bank Indonesia the non-performing loan ratio (NPL) declined from 50% to 30% by end 1999. IBRA already purchased 36% of the total NPLs in the financial system. It has also raised \$2bn from asset sales.	Progress is slowest among the five countries. The government, however won an important test before the Supreme Court as it affirmed IBRA's right to seize pledged assets.
Korea	Government-led	Korean Deposit Insurance and Korean Asset Management Company (KAMCO)	The banking system NPLs reaching only 10% by end 1999. Further, 52% of the total NPLs has been transferred to KAMCO.	Regulations involving Strengthened and are in line with the main Basle Recommendations.
Malaysia	Government-led with market framework	Danaharta and Danamodal	Danaharta already removed all non-performing debt larger RM5m and is in the process of restoring and recovering value. It has purchased 55% of total NPLs by 30 June 2000.	Major reforms were emphasized on strengthening bank and corporate supervision.
The Philippines	Government-led		The <i>Bangko Sentral ng Pilipinas</i> extended liquidity support when NPL ratio increased to 15%. However, it was left to the banks to work on improving their Asset portfolios.	Poor regulation continues to cloud the banking sector with the Banking Secrecy Act as an impediment to effective supervision.
Thailand	Market-led	Financial Institutions Development Fund (FIDF)	No dramatic results occurred with NPL ratio still high at 38% by end 1999. Assets of 56 suspended companies were taken over by the Financial Restructuring Agency.	Banks have yet to strengthen their credit analysis and risk Management. Additional capital is still needed by the banking system.
Source: Asia Recovery Report 2000.				

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Chapter 2

The New Regionalism: Is it a Building Block for Multilateralism?

2.1 Introduction

At the time the Uruguay Round (UR) of the General Agreement on Tariffs and Trade (GATT) was being negotiated, several policy concerns had been raised about regional trading arrangements (RTAs), broadly defined as preferential trade agreements (PTAs) among a subgroup of economies. This definition includes free trade areas (FTAs) and customs unions (CUs). Beginning in the middle of the 1980s, there has been a resurgence of initiatives to form PTAs, a phenomenon popularly referred to as the new regionalism, alongside efforts toward multilateral trade liberalization, or for short, multilateralism.

The use of the word “new” is meant to distinguish the recent RTAs from the PTAs that emerged after World War II, which, with the exception of that in Western Europe were all virtual failures (see Bhagwati 1993, Ethier 1998, and Krueger 1999). According to Krueger, the trend toward multilateral free trade from the late 1940s to the late 1970s dominated tendencies toward CUs or PTAs. But in the late 1980s, she noted a change in attitude, particularly on the part of the United States. Specifically, she pointed out that after a GATT ministerial meeting in 1982 adjourned without agreeing on a new round of trade negotiations, the US announced that it would seek a more open trading system based on a two-track approach. One track led to multilateralism, while the other pursued “GATT-plus” arrangements with other economies receptive to open trade beyond that agreed under GATT.

Subsequently, the US played an active role in the formation of some FTAs, thereby providing an impetus to the new regionalism. After successfully negotiating bilateral free trade areas with Israel and Canada, the US proposed a hemispheric FTA with the Enterprise for the Americas Initiative (EAI), and initialed the launching of the North America Free Trade Agreement (NAFTA) with Canada and Mexico. At the same time, the European Community (EC), the first successful example of a PTA, expanded, bringing in Greece, Portugal, Spain, Sweden, and Norway. In the southern cone of Latin America, an agreement was reached among Argentina, Brazil, Paraguay, and Uruguay to form a Southern Common Market or *Mercado Comun del Sur* (MERCOSUR). In Southeast Asia, an ASEAN Free Trade Area (AFTA) was formed among Brunei Darussalam, Indonesia, Malaysia, the Philippines, Thailand and Singapore. Australia and New Zealand established the Closer Economic Relations (CER) agreement.

The new regionalism caught the attention of both economic theorists and policy makers (see, for example, the collection of papers in De Melo and Panagariya 1993, Bora and Findlay 1996). During the GATT-UR negotiations, one of the major concerns was whether RTAs were forces for the successful completion of an international trading arrangement based on the most-favored-nation (MFN) clause. Under MFN, tariff privileges accorded to one member country cannot be withheld from other members; in other words, non-discrimination applies. The MFN principle was at the core of the various rounds of negotiation under the GATT, an arrangement that developing economies welcomed, as

they were able to access the bilateral trade privileges forged between developed economies.

There was a divergence of opinion then on whether regional trading arrangements (RTAs) tended to promote worldwide economic integration. Critics asserted that RTAs were stumbling blocks to multilateralism and that they were inherently discriminatory since tariff privileges were not extended to non-members. Others, however, viewed RTAs as complementary to open multilateral trade governed by rules. Moreover, with costly negotiations, supporters asserted that the presence of a few major trading blocks would facilitate the move towards multilateralism.

In any event, the GATT-UR negotiations were completed in 1994, giving rise to the World Trade Organization (WTO), the successor organization to the GATT. Under the various rounds of GATT negotiations, average tariffs on manufactured goods declined from more than 40 percent to about 7 percent, exclusive of the UR reductions. Once the latter are phased in, the average tariff rate is bound to go down further.

Article XXIV of the GATT permitted the establishment of PTAs under certain conditions. Under this article, (1) duties and other restrictive regulation of commerce should be eliminated on “substantially all the trade” items; and (2) the PTA was not to increase protection against the rest of the world. Moreover, there was to be a timetable for achieving free trade among the members. Under Article XXIV, a customs union, an arrangement involving zero tariffs for those within the union and a common external tariff for those outside, seems eligible as exception to open multilateral trade (see Dam 1970, Bhagwati 1993, and Krueger 1999).

At this stage, the question of whether the new regionalism is a stumbling block or building block in the push for international economic integration persists and continues to be debated (see, e.g., World Bank Economic Review 1998, Krueger 1999, Panagariya 2000). This debate is not likely to simmer down soon considering that several new FTAs are still being initiated, due in part perhaps to the failure of the Ministerial Meeting held in Seattle, the United States, in December 1999 to draw up an agenda for the next round of WTO negotiations. The issues surrounding RTAs are of special relevance to APEC, many of whose member economies are either in existing RTAs or in a discussion about forming one.

At least two major strands of the debate on the new regionalism have surfaced. One uses the Viner perspective (1950) on the possibility of trade diversion, rendering RTAs a stumbling block to multilateral trade liberalization. The other strand, which considers RTAs a building block, argues that the framework for looking at the new regionalism has to go beyond mere gains from commodity trade. Ethier (1998), for instance, points out that the new regionalism is taking place in an environment that involves foreign direct investments (FDI) and where the developing economies that are in the RTA are unilaterally adopting policy reforms that afford increasing returns to scale from investments, yielding dynamic gains to them that exceed those from plain commodity trade.

This chapter is in the nature of an update on the state of the debate on the new regionalism. Existing issues on whether RTAs facilitate or impede multilateralism are revisited. To get some possible answers, the key features of some existing and prospective RTAs are

examined. To set the stage for this, a review of the value of MFN is undertaken in Section 2.2. This is followed in Section 2.3 with a discussion of some existing analytical approaches to the trade and welfare effects of the new regionalism, beginning with the insights of Viner (1950) about PTAs and CUs, and on to the arguments that Ethier raised in support of the new regionalism. The survey of the arguments for or against RTAs is helpful in identifying some criteria with which actual and proposed RTAs can be assessed for consistency with open multilateral trade. Section 2.4 presents some empirical examples of existing and prospective RTAs involving APEC member economies, describing the features that appear to be aligned with multilateral trade liberalization. Finally, Section 2.5 makes some concluding remarks.

2.2 The Value of MFN

The MFN treatment or principle of non-discrimination is central to the GATT and to its successor, the WTO. As embodied in Article 1, each contracting party is obliged to grant MFN treatment? in its own markets to all other contracting parties. In contrast, in the absence of MFN, trading economies that resort to bilateral tariff setting can exclude non-contracting parties from enjoying the agreed-upon tariff privileges. It is MFN that developing economies have sought and endeavored to strengthen since the GATT's inception in 1947. Underlying the clamor for "trade, not aid" in the aftermath of World War II was the desire for MFN treatment (see, e.g., Johnson 1967). Today, it is also MFN treatment that is actively being pursued by economies that are still not contracting parties in the WTO, such as China.

The value of MFN treatment to developing economies can emanate from a variety of sources. The most obvious is the improved capacity of developing economies to capture the tariff privileges that are bilaterally negotiated by developed economies and to enhance market access. The immediate likely effect of an MFN is an increase in developing-

country exports to developed-economy markets. Early on, Baldwin and Murray (1977) estimated the net economic benefits of MFN tariff reductions, and they were clearly positive. Similar attempts to quantify the aggregate trade effects of tariff reduction were done for the members of the Asia-Pacific Economic Cooperation (APEC) under preferential, conditional and MFN trade liberalization scenarios; the expansion in trade was largest for the MFN scenario (see Economic Committee 1997b).

More recently, Ghosh, Perroni, and Whalley (1998) used a computable general equilibrium model to estimate the benefits and costs of MFN tariff reductions in the EU and in the NAFTA to seven groupings of economies all over the world, namely, ANJ (Australia; New Zealand; and Japan), RIA (Rich Asia: Indonesia; Hong Kong, China; Korea; Malaysia; the Philippines; Thailand; and Singapore), POA (Poor Asia: China; India; Rest of South Asia), NAF (NAFTA: Canada; USA; and Mexico), SAM (South America), EUR (Europe), and ROW (Rest of the World). The benefits in the form of increased trade were positive, though not large, for developing economies like those in Poor and Rich Asia, as well as for ANJ. EU and NAFTA economies lost from a worsening of their terms of trade. The relatively small magnitudes of the trade benefits to developing regions and the costs to the developed were attributed to the choice of 1992 as base year for the simulations; at that point in time, the external tariffs of the NAF and EU were already quite low.

Ghosh, Perroni, and Whalley, however, further explored the value of MFN treatment? by considering the impacts of two MFN constraints. One is a constraint on retaliatory actions should they occur in the WTO; the other is a constraint imposed on trade bargaining. Under the first constraint, a developing economy cannot be singled out for retaliation. As for the second, developing economies cannot be forced to negotiate bilaterally with developed economies since MFN treatment is multilateral. In view of this, developed economies cannot threaten developing economies, forcing them into making concessions. Based on the authors' quantitative estimates, the benefits from MFN treatment are the largest when large economies are restrained from negotiating bilaterally with developing economies, a bargaining situation that often involves side payments, say, intellectual property rights and domestic tax treatment. The writers conclude that this constraint on bilateral bargaining is valued more by developing economies than the direct trade creation effects of MFN.

Though the evidence stems largely from quantitative simulations, it is widely accepted that an MFN treatment yields gains not only from improved market access on the part of both developed and developing economies but also from the restraints MFN treatment puts on bilateral negotiations that tend to extract maximal concessions from developing economies. Krueger (1999) has noted that once the tariff reductions from the GATT-UR are phased in, average *ad valorem* tariffs are expected to go down further to 3 to 4 percent in the European Union, Japan, and the U.S., thereby expanding again the opportunities for market access. In assessing the value of MFN treatment, therefore, some writers have proposed the use of competitive equilibrium models where these gains from MFN matter theoretically.

Bagwell and Staiger (1999), for example, assessed the efficiency and welfare implications of MFN treatment in conjunction with preferences, production, endowments, and exchange structure. They used as starting point the inefficiencies from unilateral trade setting, such as, those that are created when an economy seeks improvements in its terms of trade at the expense of foreign exporters. In this environment, governments have an incentive to go for MFN treatment, given the opportunities for remedying terms-of-trade inefficiencies. Down the road, MFN treatment sets limits on acceptable behavior during bargaining, with salutary effects on the outcomes. Recalling Ghosh, Perroni, and Whalley, similar restraints imposed by MFN treatment deliver the greatest benefits to developing economies. Bagwell and Staiger's competitive equilibrium model may be viewed as an analytical effort toward capturing the widely accepted gains from an MFN treatment, permitting reciprocity and non-discrimination to emerge as a matter of choice.

Theoretically, a physical environment can be described where unilateral or bilateral tariff setting policies result in multiple equilibria, some of which are inefficient. For instance, Maggi (1999) showed that the value of MFN lies in the coordinative efforts economies undertake to achieve efficient equilibrium outcomes. In addition, since contracting parties have to deal with asymmetric information, the WTO through its Dispute Settlement Procedure (DSP) can reduce the monitoring or verification costs to small economies if and when WTO violations are committed.

In view of the gains from MFN treatment, contracting parties endeavor to protect and strengthen it. Meanwhile, economies that are not yet contracting parties aggressively seek it. Any effort to weaken MFN treatment is thus resisted. Under the WTO, the forces that

tend to dilute MFN treatment include anti-dumping (AD) measures and voluntary export restraints (VERs). In addition, Article XXIV, by allowing PTAs, is viewed by some as potentially damaging to MFN treatment, although others consider PTAs complementary to a rules-based multilateral trade system. This debate is dealt with in the next section.

2.3 Assessing RTAs

Do RTAs impede or facilitate the move towards a multilateral trading system anchored on MFN? If they impede, under what conditions can they be made effective instruments for multilateralism? These questions have endured in view of the resurgence of RTA initiatives in the second half of the 1980s.

The analysis of the trade and welfare effects of RTAs is typically at two levels. At one level, the trade, production, and consumption effects of RTAs on individual economies are studied; second, the effects of RTAs on the time path of the multilateral trading system are explored. Most of the issues constantly being raised by developing economies pertain to the latter, reflecting apprehension about the dangers posed by RTAs to MFN.

Trade and Welfare Effects

The starting point in the analytical assessment of the trade and welfare effects of RTAs is Viner (1950). Viner has stressed that the key issue about RTAs is whether they are trade creating or trade diverting. Suppose from an initial equilibrium position with non-discriminatory tariffs, economies A and B decide to form an FTA. Assume that a differentiated commodity, y , is produced through a constant returns production function in several economies. Suppose after the formation of the FTA, economy B is able to export y to A. Is this good or bad? Using Viner's arguments, it depends on the pre-FTA supplier of y to A. If A is a high-cost producer of y and it used to supply y , then a shift to the low-cost producer B is trade creating. However, if before FTA, y is supplied to A by a third economy C, then this means that C is a low-cost producer of y and a shift to B as supplier of y means a shift from a low-cost producer to a high-cost producer. This is trade diverting and it leads to a decline in global welfare. When NAFTA, for example, was being formed, developing economies like India warned about the risks of trade diversion to Mexico. If the increase in trade within NAFTA economies was at the expense of trade with more efficient producers, then worldwide welfare would decline.

Krugman (1991) has proposed a framework for assessing the trade creating or diverting effects of RTAs based on a theory of trading bloc formation. The world is assumed to be divided into several production units, each one producing a distinct good. The analysis shows that global welfare is maximized in two cases: when there are several trading blocs and when there is only one. Krugman's theory of trading bloc formation and its welfare effects also incorporates a concept of "natural" trading blocs. Transportation and communications costs provide incentives among neighboring economies to form RTAs. Krugman argues that any reduction in welfare is likely to be small in this case. The gains from freeing intra-regional trade are large, while the costs of reduced inter-regional trade are small. Bhagwati (1993) has disagreed with Krugman on "natural" trading blocs, citing empirical foreign trade data showing that much trade takes place between and among very distant economies; trade diversion is thus likely to be huge. Krueger (1999) has also taken issue with Krugman on this point. She says trade is still based on factor endowments and if

neighbors like the USA and Canada are similar in this sense, it is difficult to conclude that trade between them would be “natural.”

Notwithstanding this difference of opinion on “natural” trading blocs, the theoretical analysis of the trade and welfare effects of RTAs shows a wide area of agreement among economists, particularly, when set in a competitive equilibrium situation. For example, the dynamic gains from RTAs are widely recognized. Differences in opinion resurface when the discussion shifts to monopolistic competition and issues about economies of scale and the distribution of rent are opened up. And when normative issues about RTAs crop up, the divergence of opinion widens further.

Stumbling Blocks or Building Blocks?

Krueger (1999) and De Melo and Panagariya (1993) in their introduction have done a comprehensive survey of the arguments on this point; the discussion here is greatly indebted to these works.

Bhagwati (1993) considers RTAs as stumbling blocks to multilateralism citing empirical data. He notes the trade diversion that ensues even when tariffs are low as in the case of US imports from Mexico under NAFTA. Levy (1997) then adds that as trade is created among the partners, stakeholders who are apprehensive about a dilution of their exports from further liberalization emerge. The greater the political power of vested interests, the higher would be the tariffs set against non-members. Trade diversion, under this line of argument, becomes pervasive with adverse welfare effects.

In sharp contrast, Ethier (1998) considers RTAs as building blocks for multilateral trade liberalization. RTAs, in his view, emerge from the success of global trade liberalization among developed economies. While he acknowledges that both trade diversion and protectionism are a constant threat, developing economies willingly join RTAs in order to lock in their trade reforms, thereby ensuring the continuous flow of trade and investments from developed economies. Ethier proposes a framework that goes beyond trade creation and trade diversion. He observes that the new regionalism is taking place amid deep structural reforms that matter not only for trade in commodities, but also for investments, knowledge transfer, and technological progress. Ethier’s model captures elements of real economies like multi-stage production with increasing returns, foreign direct investments, technological progress, and factor mobility. Seen in this light, RTAs can yield welfare gains that extend beyond mere gains from trade.

As the world gets reduced to a few trading blocs, bargaining costs decline. With only a manageable number of trading blocs negotiating, the process of multilateral trade liberalization can be speeded up. Strategically, the acceleration of multilateralism can be accomplished by organizing blocs committed to open regionalism, under which the trade privileges of the members are not withheld from non-members.

In the context of the GATT-UR, the US, as Bhagwati (1993, p.45), De Melo and Panagariya (1993, p. 5, 10-11) have observed, took this approach. After noting the slowness of the GATT-UR process, the US endorsed organized blocs like the European Community and saw them as helpful instruments for completion of the UR negotiations. This was in line with the open membership that, according to Bhagwati, William Brock,

the then US Trade Representative, had proposed. Brock had offered an FTA to Egypt and ASEAN simultaneous with the offer to Israel.

In addition, RTAs can help secure further liberalization of global trade to the extent that producers are induced to lobby for reductions when tariffs on intermediate goods are higher than those of the other member economies prior to the formation of the RTA. The incentive emanates from the dictates of international competitiveness; the producers' lobby drives down the tariffs on intermediate goods, forcing multilateral tariffs to the level of the RTA tariffs. Moreover, RTAs do not maintain a common external tariff for non-members. And so they have the flexibility to go beyond what is taking place multilaterally; the GATT-plus in the APEC process is consistent with this notion.

Another argument for why RTAs can be a building block for multilateralism comes from the demonstration effects of being a participant. The observed trade creation and the investment it induces may lead other economies to soften their resistance to multilateral trade liberalization.

It seems clear that there are strong arguments backing the proposition that RTAs can be building blocks for multilateralism. Nonetheless, the fact remains that trade diversion and protectionism against non-members are credible threats. As Krueger (1999) emphasized, protectionists may espouse RTAs to avoid further multilateral liberalization. In addition, members benefiting from the trade creation may not want their gains dampened by further multilateral liberalization. In any event, it seems fruitless to say that RTAs should not be allowed under the WTO. So how can the threats to multilateralism be dampened? And how can the new regionalism be a potent instrument for further multilateral trade liberalization?

De Melo and Panagariya suggest reforming the rules of the game so that regionalism complements multilateralism. As suggested by Bhagwati (1993, p.45), open-ended regionalism that is not geographically circumscribed is a sound principle. At this stage, there are several types of RTAs, some with higher potentials for trade diversion and risks for protectionism than other arrangements. Lastly, Bhagwati also proposed the elimination of voluntary export restraints (VERs) and the tightening of the criteria for anti-dumping (AD).

The debate, which is largely unsettled at this stage, has identified some criteria against which RTAs might be assessed to determine their potentials for advancing the cause of open multilateral trade. The next section focuses on some of the existing and prospective RTAs with which some APEC economies are associated. Their main features are preliminarily assessed to get an idea whether or not they support the open regionalism espoused by APEC.

2.4 Some Empirical Illustrations

This section describes selected existing and prospective RTAs involving some APEC member economies to illustrate key features of the new regionalism and to assess if they help advance the cause of multilateralism. These new RTAs, it seems clear, go beyond mere trade in commodities and services to incorporate deeper forms of integration, such as, liberalization of investment regimes, adoption of mutual recognition arrangements, and

in some instances, harmonization of competition policy. Efforts are made to ensure true integration of markets. Furthermore, the new RTAs tend to be more outward-oriented than the ones established more than two decades ago. Moreover, a number of them include both developed and developing economies, giving rise to possibilities for greater specialization in production and trade. All these suggest that the new RTAs open up new opportunities to advance multilateral trade liberalization.

Table 1 shows that with a few exceptions, namely, China; Hong Kong, China; Chinese Taipei; Japan; Korea; and Russia, the member economies of APEC currently belong to one or more sub-regional blocs. In addition, most of them are in the process of establishing formal links with other blocs within and across continents. For instance, presently under study is the feasibility of forming free trade areas between existing blocs like AFTA and CER, or among NAFTA-MERCOSUR-Andean Community and other RTAs in the Western Hemisphere. Individual economies, such as, Chile and Korea, have initiated studies and discussions at various fora to explore the possibility of trade-bloc formation.

Table 1: Sub-regional Trade Agreements within APEC

APEC Member Economy	Sub-regional Integration Arrangement
Australia	CER
Brunei Darussalam	AFTA
Canada	NAFTA; FTAA
Chile	MERCOSUR; FTAA; Chile-EU
China	
Hong Kong, China	
Indonesia	AFTA
Japan	
Korea	
Malaysia	AFTA
Mexico	NAFTA; Mexico-EU FTA
New Zealand	CER; Singapore-New Zealand CEP
Papua New Guinea	Sparteca
Peru	Andean Community; FTAA
Philippines	AFTA
Russia	
Singapore	AFTA; Singapore-New Zealand CEP
Chinese Taipei	
Thailand	AFTA
United States of America	NAFTA; FTAA
Viet Nam	AFTA

What features embodied in the new existing and prospective RTAs can help advance open multilateral trade? To arrive at some tentative answers, the next section looks at the following RTAs: Andean Community, AFTA, CER, MERCOSUR, and NAFTA. It also takes a cursory look at four proposed RTAs, namely, the AFTA-CER FTA, the Free Trade of the Americas (FTAA), the Singapore-New Zealand Closer Economic Partnership (CEP), and non-governmental efforts toward a Japan-Korea FTA.

Some Features of Existing RTAs

Comprehensiveness of Trade Liberalization

The first feature that is examined is the extent to which existing RTAs are consistent with Article XXIV provision on comprehensiveness of trade liberalization.

The Andean Community, formerly known as the Andean Pact, is presently composed of five members Bolivia, Columbia, Ecuador, Peru, and Venezuela.¹ Formed on 26 May 1969, it has been hampered by several factors, including changes in membership. Chile withdrew in 1976; Peru pulled out in 1992, but rejoined in 1997. Now back on track, the FTA seeks to include all products under tariffs. Furthermore, the group is gearing itself to the formation of a common market by strengthening the liberalization of capital and labor movements inside the bloc. In June 1998, members signed an agreement that would extend liberalization to services trade (Stephenson 1999).

The Association of Southeast Asian Nations (ASEAN) evolved from a group established in 1967 to encourage cooperation in economic, political, and cultural fields among its five members: Indonesia, Malaysia, the Philippines, Singapore and Thailand. It has since expanded to include Brunei Darussalam, which joined in 1984, and Viet Nam, in 1995. Other new members joined the group in 1999: Cambodia, Lao-PDR, and Myanmar. Since 1978, when a preferential trade arrangement was put in place, several attempts at encouraging greater intra-regional trade have been made but they have not been successful. Proof is that as late as 1989, only about 3 percent of all goods were eligible for regional trade preferences. But in 1992, with Singapore in the lead, the members undertook a series of talks leading to the creation of the ASEAN Free Trade Area (AFTA).² The latter has a timetable for the elimination of tariffs on intra-regional trade covering nearly all sectors, including agriculture, although phase-in periods for some sensitive sectors extend up to 2010, and a small number of sensitive sectors are temporarily excluded. The timetable for completion of the free trade area has been accelerated, originally from 2008 to 2003, then to 2002 for the six original signatories to the agreement on the Common Effective Preferential Tariff (CEPT). In 2000, about 80 percent of all tariff lines in intra-ASEAN trade are tariff free, and 98 percent have a less than 5 percent tariff. A limited liberalization of services has also been underway since 1995 (Stephenson 1999).

MERCOSUR'S original members – Argentina, Brazil, Paraguay and Uruguay – are not members of APEC, but Chile is now an associate member of MERCOSUR. Created in 1991, MERCOSUR seeks the formation of a common market, with free movement of goods, services, labor and capital. Since the beginning of 1995, a common external tariff has been introduced, with some exemptions to be harmonized over a six-year phase-in period. About 90 percent of intra-bloc trade is currently tariff-free, although some sectors will remain exempt until 2000 (Frankel 1997).

The Australia-New Zealand Closer Economic Relations (CER) has its predecessor in a 1965 accord establishing a limited free trade area that removed tariffs on trade in forest

¹ Information on the Andean Community is derived mainly from its website (<http://www.comunidadandina.org>).

² The ASEAN Secretariat based in Jakarta regularly publishes books and monographs about economic and other forms of cooperation in ASEAN.

products and some manufactures by 1977. In 1983, the two economies decided to expand this accord to include all trade under the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or CER). It has a comprehensive coverage of trade barriers, touching on non-tariff barriers, subsidies, countervailing duties, antidumping, and government procurement. Since 1988, the two members have agreed on national treatment of trade in most services.

On 1 January 1994, the North American Free Trade Agreement (NAFTA) was formed among the US, Canada, and Mexico. NAFTA superseded the previously existing Canada-US FTA (CUFSTA). Earlier, there were bilateral trade agreements between the US and Mexico that covered certain sectors, but involved some trade barriers such as subsidies and countervailing duties. The NAFTA is based on liberalization of goods trade, including agriculture, although for the latter there is a phase-in period of up to 15 years. It also liberalizes investment, services, and intellectual property rights. According to Frankel (1997), rules of origin have hampered some liberalization schedules for textiles and automobiles. Meanwhile, the energy sector is excluded due to Mexico's sensitive oil sector, although it was included earlier in CUSFTA.

Levels of Protection vs. Non-members

In line with Article XXIV, RTAs should not raise trade barriers against non-members any higher than their levels before the trade blocs were formed. But as noted by the World Bank (1999), there is a large difference between many developing economies' applied or actual tariffs and the ceilings of their formal bindings under the GATT which makes tariff increases following RTA formation possible. The World Bank study cited Mexico's ability to nearly double tariffs on 503 import items from non-NAFTA economies in 1995 without violating the bindings it has committed itself to under the GATT. And, in further circumvention of the rules, some economies use contingent protection or technical barriers.

To determine whether regional bloc formation has made member economies more or less protectionist, Foroutan (1998) examined the external trade policies of RTAs involving developing economies. One of her findings shows that Latin American RTAs now exhibit the lowest average tariffs and non-tariff barriers among developing economies in contrast to non-RTA economies that have much less tariff cuts. Moreover, even under the Uruguay Round, Latin American RTA members are found to have reduced their tariffs more, and bound more of them, than economies that are not members of RTAs.

Although there are indications that RTAs do not necessarily lead to greater protectionism, it cannot be asserted with certainty that they encourage or hinder multilateral or unilateral liberalization. Foroutan (1998) concludes that there is no causal link between trade liberalization and RTA membership. The reason behind this is that there are examples of both liberalizing economies that did not belong to any regional arrangements and members of effective FTAs that did not liberalize.

However, it can also be argued that belonging to a RTA can, in some cases, provide the stimulus for an economy to liberalize its trade regime. The liberalization programs undertaken by other members in the regional bloc may provide the 'demonstration effect' needed by members that are still hesitant to adopt such policy reforms. Virtually tariff-free Singapore in AFTA provides an example of such effect. Moreover, the positive experience

associated with trade liberalization with a smaller set of partner economies in a regional bloc may provide the confidence needed by policymakers to embark on liberalization programs on a wider, multilateral scale. The experience of New Zealand is a case in point. The initial fears of opening up its markets to Australia, a bigger, more economically advanced partner in a free trade area severely limited the scope of liberalization, thus constraining the effectiveness of earlier trans-Tasman trade agreements. However, as both Australia and New Zealand became more confident with outward-oriented policies, commitments made under the original CER were strengthened and the scope of the agreement was even extended to new areas of international commerce (see Bureau of Industry Economics 1995). Moreover, both economies undertook a substantial program of trade liberalization that reduced the high levels of protection accorded to their agricultural and manufacturing sectors. Such demonstrations of the possibilities of achieving the dynamic effects of bloc-formation itself – such as, productivity improvements, scale economies, increased FDI – served as lessons to CER itself and to economies outside the regional bloc to move farther away from continued application of protection policy. In the case of the Philippines, one of the reasons for the adoption of a uniform tariff policy of 5 percent by 2004 is the avoidance of the trade-diverting effects of AFTA once the CEPT comes into force.

Evidently, economies belonging to sub-regional groups within APEC are also those that have put in place a number of policy initiatives that have led to more, rather than less, trade liberalization in relation to non-member economies. They are at the forefront of initiatives to restart a new round of WTO negotiations, even after attempts to do so failed at Seattle. Apart from a new round, it can also be said that the Cairns Group (led by Australia and which includes as members a number of developed and developing agricultural exporters within APEC), the US, and MERCOSUR are spearheading the mandated negotiations on agriculture within the GATT-WTO framework, to tackle the issues of agricultural protection (see www.wto.org).

Timelines of Liberalization

Article XXIV of the GATT specifies that “any interim agreement shall include a plan and schedule for the formation of such a customs union or of such a free trade area *within a reasonable length of time*” (italics supplied). According to the “Understanding on the Interpretation of Article XXIV of the GATT,” the “*reasonable length of time*” means ten years. In the case of the 1994 *Bogor Declaration*, APEC Leaders have committed to open trade and investment in the Asia-Pacific region by 2010 for developed member economies of APEC and 2020 for developing member economies. The sub-regional groups within APEC are aiming at earlier deadlines for liberalization, for example, 2005 for the Andean Community to complete its customs union; 2010 for ASEAN-6, and 2015 for the four newer members. The CER economies have already achieved full trade liberalization, and the Singapore-New Zealand Closer Economic Partnership envisages removal of all tariffs by 1 January 2001. Moreover, arrangements have been made to allow for periodic reviews of compliance with the scheduled liberalization.

The *Bogor Declaration* has taken APEC on the route to liberalization earlier than has been achieved under the multilateral negotiations of the GATT-WTO. In the meantime, there are signs that sub-regional blocs within APEC can catalyze liberalization between participating economies in advance of the *Bogor* deadlines.

Intra- vs. Extra-regional Trade

A fear that RTAs may serve as stumbling blocks to multilateral free trade stems from the possibility that their formation may bring about increased intra-bloc trade at the expense of non-members. Some authors, to show the tendency of regional blocs to divert trade into the region, have used simple intra-regional trade as a proportion of the region's total trade with the world. However, as Frankel (1997) notes, this measure is flawed because it is dependent on the absolute size of the regional bloc. If, for example, APEC showed a much higher ratio (0.74 in 1994) than the Andean Community (0.10 in 1994), it may simply be because the former comprised a large group of economies that has a large share of the world economy, and hence, would inevitably trade a lot with each other. A way to correct this is to divide the intra-regional trade share by the region's share of world trade³ (Table 2).

Table 2: Intra-regional Trade Concentration Ratios, 1962 - 1994

RTA	1962	1965	1970	1975	1980	1985	1990	1994
Andean Community	0.29	0.69	1.57	2.63	3.37	4.41	8.06	12.63
MERCOSUR	2.45	6.42	5.57	3.82	6.14	4.84	9.07	12.84
ASEAN 6	9.57	9.22	8.22	4.86	4.08	5.11	3.98	3.60
NAFTA	1.63	1.76	1.93	2.17	2.08	1.95	2.09	2.20
CER								
EU 15	1.24	1.28	1.33	1.41	1.47	1.58	1.51	1.63
APEC	1.64	1.69	1.82	1.86	1.82	1.74	1.76	1.63

Source: Table 2.2 in Frankel 1997.

One important observation is that the regional blocs generally tend to trade more intensely within the bloc than with the rest of the world, as shown by the concentration ratios that are greater than one. This may be due to a large extent to geographical proximity, since trade tends to be greater among economies that are geographically close to one another, whether or not there is a formal regional arrangement. However the question arises as to why such a trend seems to be rising for some (especially for the Andean Community and MERCOSUR), falling for others (ASEAN-6) and quite flat for still others (APEC). Clearly, this cannot be due to changes in geographical proximity. This suggests that trade is becoming "more regionalized over time in some parts of the world" (Frankel 1999, p. 31). However, whether this is due to the formation of RTAs in these regions or to other policies is not clear.

Using a gravity model, Frankel has tried to isolate the effect of forming a regional trading bloc from other variables that determine bilateral trade, such as, market size, per capita income, bilateral distance, common borders, and common languages. His results show that belonging to a trade bloc is significant only for the Andean Community, MERCOSUR, and the CER. The case of MERCOSUR⁴ is interesting in that the bloc effect was insignificant during 1965-75, but after that it rose and became statistically significant,

³ The figures then show whether there is a tendency for the region to concentrate trade within the region. If regional trade were according to geographic patterns that are proportionate to the distribution of world trade, then the concentration ratio would be equal to one. Ratios greater than one indicate a trade is concentrated within the region. It should be pointed out that the data utilized has its limitations: (1) the results may be distorted to a greater or lesser extent by the performance of the dominant economy or economies in the group; (2) the data was analyzed in 1994, which means that it does not reflect the full effects of the Uruguay Round and other liberalization efforts.

⁴ Chile is excluded in this estimation.

especially after 1990. In the case of the Andean Pact⁵, the bloc effect was insignificant (negative) and became significant (positive) only after the reinvigoration of the Andean Pact in 1992. On the other hand, the bloc effect for ASEAN depended on whether other bloc effects were tested simultaneously. When the East Asian bloc effect was introduced, the strong bloc effect for ASEAN disappears, implying that ASEAN traded strongly intra-regionally only because most Asian economies do so. The effect of NAFTA, however, was almost never significant, even in 1992 when it was negotiated. However, this may be due to the small number of observations in Frankel's study (p. 91).

Frankel's results are somewhat mitigated by the results of Soloaga and Winters (1999) who test if the formation of new RTAs influenced trade in the nineties. They found a positively significant trend in the estimated coefficients for bloc members' overall imports only for MERCOSUR, not for the Andean Community. For ASEAN, the Soloaga-Winters study indicates that the intra-bloc trade coefficient was negative, especially between 1987 and 1995 and that the bloc's propensity to import from bloc members was even significantly lower in 1995-96 than in 1986-88 and 1980-82. For NAFTA, Soloaga and Winters confirm Frankel's results that intra-bloc trade coefficients were insignificant. The implication is that there was no appreciable impact from NAFTA formation either on intra- or extra-bloc trade when gravity variables were simultaneously present. Meanwhile, a study by Yeats (1997) showed disturbing signs that MERCOSUR's intra-regional trade was growing most rapidly in areas where the member economies were not internationally competitive and that domestic producers were re-orienting exports to local markets to take advantage of higher prices associated with more restrictive trade barriers.

Overall, the evidence does not seem supportive of the thinking that RTAs increase intra-regional trading activity at the expense of non-members. For AFTA and NAFTA, regional bloc formation has not prevented member economies from trading with the rest of the world once gravity variables are taken into consideration. A World Bank study (1999) has likewise concluded that there is no evidence that regional agreements are a stumbling block toward multilateral trade liberalization, although it also says that it has found no compelling evidence that RTAs have served as stepping stones for multilateral liberalization.

Trade Creation vs. Trade Diversion

A major apprehension about RTAs pertains to trade diversion effects away from non-members. The Soloaga and Winters study provides evidence of trade-diversion only for EU and EFTA, but for other RTAs, they found that trade creation exceeded the trade diversion effects.

This is corroborated by CGE modeling studies undertaken by different authors at various time periods (see Table 3 from De Rosa 1998). For AFTA, two studies show basically trade-creating effects on a net basis. Two CGE models of MERCOSUR report that a regional bloc would be ex-ante trade creating, even without a modest trade diversion. Meanwhile, Chile's accession to either MERCOSUR or NAFTA is seen to be beneficial, though not significantly, to Chile by the study of Hinojosa-Ojeda, Lewis, and Robinson

⁵ Again Chile is excluded in membership of the Andean group, but includes Peru.

(1997). But a study by Harrison, Rutherford, and Tarr (1997)⁶ suggests that Chile would benefit from accession only in NAFTA, not in MERCOSUR. The results for NAFTA likewise show net positive welfare effects, in varying degrees, depending on the assumptions of the studies.

These studies thus tend to allay the fear about the trade diversion effects of the new regionalism.

Open Access to New Members

Another way by which regionalism can be rendered supportive of multilateralism is if, according to Kemp and Wan (1976), non-member economies are allowed to join the regional blocs that are being formed. This would make the FTA an ever-expanding bloc, thereby tending to improve welfare of economies at every stage. In other words, there must be open access in membership. While possibilities for enlargement do not necessarily constitute total openness, there is a greater chance for regionalism to contribute to multilateralism if the regional bloc is receptive to admitting non-members, rather than shutting them out.

In the case of the Andean Community, there have been efforts to create a free trade area with MERCOSUR. Indeed, the formation of a free trade zone by 1 January 2002 has just been announced after a summit of twelve South American economies in Brazil in early August this year. Moreover, the Andean Community has been active in the launching of negotiations for the establishment of the Free Trade Area of the Americas (FTAA) that will link in an FTA agreement the entire Western Hemisphere, with the exception of Cuba.

AFTA has expanded in the 1990s to include three more economies in Indochina, namely, Cambodia, Lao PDR and Myanmar. It has also been in dialogue with East Asia (Japan, South Korea and China), holding “ASEAN-Plus Three” meetings following the Manila Summit of 1999. Meanwhile, the CER has shown interest in linking up with other regional groups, of which the most developed initiative is the AFTA-CER Linkage. AFTA and CER Ministers agreed in October 2000 to work toward a Closer Economic Partnership between the two groupings, taking account of recommendations made by a high-level task force.

In the case of MERCOSUR, a free trade zone is being formed with the Andean Community. Moreover, an accord with EU was agreed in December 1995 to establish an FTA by 2001 (see <http://worldbank1.org>). Chile has been an associate member since 1996, while Bolivia was accepted as a member in December 1996. Peru has expressed interest in forging an FTA with MERCOSUR. Chile is pursuing free trade agreements with South Korea and the European Union, and it has already signed bilateral trade agreements with Canada, Mexico, Bolivia, Colombia, Ecuador, Peru, Venezuela and Central America (Costa Rica, Guatemala, Honduras, El Salvador and Nicaragua).

Even NAFTA, which initially rejected new members, does not seem to be averse to linking up with other economies and regional blocs (Hufbauer and Schott 1996). Indeed,

⁶ The Harrison, Rutherford and Tarr (1997) study, however, differed from other multi-country CGE models since it used an import-demand elasticity of substitution of 30, based on the rationale that in the long-run of about ten years or more, consumers will take every opportunity to substitute lower-priced imports for higher-priced ones, assuming that they are very similar.

preliminary talks held in Florida with other blocs in the Southern Hemisphere centered on the possibility of forming the FTAA.

Evidently, there are afoot initiatives to link different existing regional blocs with one another or to link economies with either other economies or other regional blocs. Some observers are worried about a division of the world into three blocs (FTAA, an Enlarged EU, East Asian-CER FTA) that might stall the move toward multilateral free trade. However, since the linkages being mulled over are between regional blocs or by economies continents (e.g. MERCOSUR-EU, NAFTA-EU or the Transatlantic FTA, Mexico-EU; Chile and Korea, Singapore and Mexico, Singapore and New Zealand), the likely outcome seems more consistent with an ever-expanding bloc that is moving closer to a 'multilateralized' world.

Toward Deeper Integration

Experience with trade liberalization has shown that integration of markets cannot come about only with integration through trade (often referred to as shallow integration). This is because trade has become highly complementary with other areas, such as, services trade, investments, government procurement, and other policies (say, those bearing on competition, intellectual property), all of which have to be harmonized in order to bring about a greater integration of markets. For instance, Australia and New Zealand have realized that antidumping problems could be eliminated by harmonization of their competition policies, or that mutual recognition arrangements (MRAs) seem necessary so that technical standards do not serve as non-tariff barriers to goods trade.

All the sub-regional integration arrangements within APEC appear to go beyond preferential trading arrangements and incorporate deep integration arrangements. The Andean Community and MERCOSUR, envisaging the formation of common markets, both have provisions for the eventual free movement of labor and capital. AFTA, on the other hand, has evolved a number of commitments on liberalizing services trade (the ASEAN Framework Agreement on Services), investments (ASEAN Investment Area), and trade facilitation, from the adoption of a harmonized tariff nomenclature to the harmonization of products standards for priority sectors and development of sectoral or product-specific MRAs. The CER looks quite mature at this stage: it covers a number of deep integration arrangements. It provides for free trans-Tasman trade in all services, with the exception of a number of services subject to existing government regulations at the time. Trade facilitation has led to standards harmonization, adoption of MRAs, quarantine harmonization, and customs harmonization. Successful harmonization of competition policies between Australia and New Zealand has led to a breakthrough in terms of removing the possibility for applying anti-dumping procedures against each other. Moreover, harmonization is taking place in business laws and intellectual property rights. NAFTA embodies WTO-plus features, such as, pacts on investment, intellectual property rights, services, and labor/environment.

Other Issues

Admittedly, RTAs still have to address a number of important issues that create stumbling blocks to the achievement of multilateral free trade. But most of these issues are not yet fully resolved even in the WTO.

Non-tariff Barriers: While there is a general agreement on the objective of removing tariffs on goods trade, some regional groups have remained quite vague on the issue of non-tariff barriers (Frankel 1997). In particular, most of the regional blocs (except perhaps the CER, which instead has strengthened , competition policy between the two members) retain the possibility of imposing contingent protection, especially the use of antidumping duties on bloc members. Within MERCOSUR, Argentina lodged 33 antidumping cases against Brazil between 1992 and 1996 (Tavares and Tineo 1997, cited in World Bank 1999). In NAFTA, Canada and the US have not abandoned the possibilities for anti-dumping against each other (Gagné 2000). In agricultural trade, some trade-retarding issues remain to be addressed. For instance, the application of sanitary and phytosanitary standards (SPS), which though science-based, may be applied in such a manner as to constitute a non-tariff barrier to trade.

Standards: Efficient systems of standards serve to reduce the costs of doing business. On the other hand, standards may be used to limit market access and thus serve as technical barrier (Findlay 2000). This had been the case with the EU until the landmark ruling of the International Court of Justice on MRAs. Among the options for adopting common standards among member economies are harmonization and mutual recognition.

Services Trade: The specific sub-regional RTAs, including, APEC member economies seem to envisage liberalization in all or most goods, generally in line with Article XXIV. However, the freeing of services trade even among members has not proceeded at the same speed as that in goods trade, in spite of GATS V. On the other hand, since the mid-1990s services trade liberalization has been manifesting itself not so much at the multilateral as at individual economy and sub-regional levels (Stephenson 1999, p. 2). In particular, the efforts at services trade liberalization in APEC and the FTAA are being cited as important complements to the multilateral effort under the GATS. Several reasons have been cited why RTAs may offer a complementary route to liberalization under the GATS: (1) labor mobility may be involved in service liberalization, and it may be more politically acceptable if limited to RTA members rather than achieved in a non-discriminatory manner; (2) quality standards must be set for which procedures must be drawn up, and again this might be much more easily achieved within an RTA (World Bank 1999).

Even then, practically speaking, the inclusion of services under APEC's "early voluntary sectoral liberalization" (EVSL) is turning out to be problematic in the light of the recent Asian crisis. In the case of FTAA, a liberalizing modality will have to be agreed upon before the rules and disciplines can be written up, and an agreement can only become effective after 2005 (Stephenson 1999).

Rules of Origin: While necessary to avoid trade diversion in the case of free trade areas, rules of origin (ROO) have nevertheless been used to hinder rather than hasten the achievement of free trade within RTAs. They can be restrictive enough to cause member economies to source high-priced intermediate inputs from other member economies due to local content requirements attached to the rules of origin. Alternatively, they might drive member economies to increase value adding, even though inefficient, just to be able to take advantage of free trade within the bloc. This has been the concern of New Zealand with regard to its textiles, clothing, and footwear industries and it has, therefore, sought reductions in the CER local content requirements for duty-free entry into Australia (BIE 1995, p. 20). Moreover, even the implementation of the ROO can be made complex, as the

in the case of NAFTA with its 200 pages of documentation on ROO. ROOs must therefore be made more transparent and straightforward so as not to become an instrument of protection within a RTA.

Prospective RTAs and Other Initiatives

The burst of regionalism in the 1990s does not seem to have abated. The stalled attempts to start a new multilateral round of negotiations in Seattle, USA, have only served to increase interest in RTAs, perhaps, as an insurance policy against the risk of failure at the multilateral front. New RTA initiatives are underway to form trade blocs within and across continents.

One initiative proposes to create a free trade area between the members of two existing FTAs, namely, AFTA and the CER. A high-level task force was established by ministers from AFTA and the CER in October 1999 to examine the feasibility of an AFTA-CER FTA. The members of the task force have found it both feasible and advisable to form such a FTA for the political and economic benefits that it will bring. Its report is referred to as the *Angkor Agenda 2000*. Ministers from ASEAN and the CER considered the *Angkor Agenda* at a meeting in Chiang Mai, Thailand, on 6 October 2000. They agreed to work towards a Closer Economic Partnership (CEP) between the two groupings, taking into account the recommendations of the *Angkor Agenda* and other issues relevant to closer economic integration. Senior officials will report back to the Ministers with recommendations in October 2001.

The content of a future CEP will be decided by ASEAN and CER Ministers. Nonetheless, it may be useful to examine the shape of the economic integration arrangement proposed in the *Angkor Agenda*. Among other things, the task force proposed that:

- a. The AFTA-CER FTA would represent a separate arrangement which would be comprehensive, covering all goods, services, and investments, and would lead to the elimination of all forms of tariff and non-tariff barriers to trade in goods and services. AFTA and the CER would maintain their respective identities;
- b. The pace of liberalization within the AFTA-CER FTA should proceed faster than that agreed within APEC. The AFTA-CER FTA would not normally go beyond the pace of liberalization which AFTA has already agreed for ASEAN members, i.e., elimination of tariffs for manufactured goods by 2010 for ASEAN-6 and 2015 for the four newer members, with some flexibility. The CER would progressively reduce tariffs for ASEAN from the conclusion of negotiations, reaching free trade by 2005;
- c. The proposed FTA should provide development assistance in the form of capacity-building measures and technical assistance and the adoption of a longer time-frame for the newer members of ASEAN; and
- d. The AFTA-CER FTA would be open to accession by any other economy or regional grouping.

Representing the largest integration effort involving developed and developing economies, the Free Trade Area of the Americas (FTAA)⁷ is envisaged to formally link up all the 34 economies of the Western Hemisphere – with the exception of Cuba – into a free trade area. The information reported here is sourced mainly from the proceedings of the 1997 Summit of the Americas held in Brazil. Formal negotiations began in March 1998 and will conclude no later than 2005. Its common objective is that of achieving free trade and investment in goods and services; it is envisioned to be fully WTO-consistent, specifically with Article XXIV and GATS V. However, the goal of deeper integration is envisaged in areas not presently under the WTO, such as, a common investment regime, government procurement, and competition policy. For this purpose, nine negotiation groups have been set up: (1) market access; (2) investment; (3) services; (4) government procurement; (5) dispute settlement; (6) agriculture; (7) intellectual property rights; (8) subsidies, antidumping and countervailing duties; and (9) competition policy. The envisioned arrangement specifically professes the principle that the construction of the FTAA will not raise barriers against non-members and will continue to avoid to the greatest extent possible the adoption of policies that adversely affect trade in the hemisphere. In consideration of the differences in both the levels of development and the size of participating economies, the negotiations will ensure the integration of the smaller economies so that they will be able to benefit equally from the trade liberalization. A novel feature of the FTAA is that it will allow elements of civil society to make their views known on issues to be negotiated. A Committee on Civil Society will be created to facilitate the input of the private/business sector, labor, environmental, and academic groups on issues under negotiation.

Negotiations between Singapore and New Zealand have led to the forging of an “Agreement between New Zealand and Singapore on a Closer Economic Partnership.”(CEP) As described in the agreement document, all tariffs will be eliminated upon its entry into force. A number of arrangements touching on non-tariff barriers have also been agreed upon. For instance, all export subsidies on goods, including those on agricultural products, will be prohibited under the CEP. Anti-dumping provisions have been retained, but are based on the WTO anti-dumping agreement, with changes that marginally tighten the thresholds before anti-dumping investigations can be started. With regard to services trade liberalization, schedules set out each economy’s initial commitments, in line with the APEC objective of free and open trade in services by 2010. A meeting between the two economies is scheduled for 2007 to identify the services sectors or measures that Singapore or New Zealand may not be able to liberalize fully by 2010. The CEP Agreement goes beyond trade matters and incorporates deeper-integration features, such as, on investments, technical, SPS regulations and standards, government procurement, and intellectual property. Openness to new members is assured, as the CEP includes a provision that enables any other member of the WTO or any other state or separate customs territory to accede or associate itself with the Agreement, subject to agreement of New Zealand and Singapore. Robust dispute settlement procedures have been agreed upon. The CEP also provides for a periodic review of the CEP to take place every five years.

Even East Asia, which had not known any RTAs in the past, seems to be nursing thoughts about creating some. On May 23, 2000, the Institute of Developing Economies, JETRO of Japan, and the Korea Institute for International Economic Policy (KIEP) issued a joint

⁷ Information on the FTAA is mainly derived from www.alca-ftaa.org.⁵

communiqué to present the results of their study on the feasibility of creating a free trade area between Japan and Korea. The idea is based on the need for closer economic relations between the two economies, articulated during the visit to Japan in October 1998 of President Kim Dae Jung, who declared, with Prime Minister Keizo Obuchi, an “Action Plan for the New Korea-Japan Partnership for the 21st Century”. As proposed by the study, the FTA will aim at a comprehensive framework to encompass an array of market-integration measures, such as investment promotion, trade facilitation, and harmonized trade and investment rules and standards, in addition to eliminating tariffs and non-tariff barriers to trade between the two economies. The communiqué explicitly mentions that FTAs are “increasingly being regarded as a pragmatic approach to achieving global liberalization”. Deep integration arrangements, therefore, are being envisioned. Bilateral cooperation is one important avenue to maximize the benefits of the FTA, so that both sides have emphasized the need for it, particularly, in industry and technology fields. There is a proposal by KIEP to establish a Korea-Japan Investment Development Bank to encourage the investments and thus reap the dynamic benefits that accrue from them. Korea, however, seems to maintain a cautious attitude on the establishment of an FTA, but KIEP sees the creation of a development bank and a committee for technical cooperation.

Even as Japan and Korea are contemplating the idea of an FTA, both economies are each in the process of talking with different trade partners: Korea with Chile, Israel, and New Zealand; and Japan on non-governmental level with Singapore, Mexico, and Chile. In particular, the proposed Japan-Singapore FTA will be a “new age FTA” in that it envisions going beyond the traditional WTO-consistent trade liberalization, investment promotion, MRAs on rules and standards, together with effective ROO and safeguard measures.

In sum, the new initiatives, in forming more sub-regional trading arrangements within APEC, appear to embody the features that make regionalism not only supportive of multilateralism but may even surpass it in terms of results. While being WTO-consistent, they go beyond trade and into deeper forms of integration not yet covered by the WTO negotiations, such as, competition policy and e-commerce.

Table 3: Quantitative Studies of Regional Integration Arrangements

Researchers	Description Model	Sectors Included	Economies	Change in Economic Welfare; Percent of Annual GDP
NAFTA				
Bachrach & Mizrahi (1992)	Ex-ante, CGE, perfect competition for Mexico & USA with differentiated products, constant returns to scale, inter-industry flows, 1988.	36 trade goods sectors, 8 services sectors. Primary factors of production, including capital, labor and energy resources. Trade goods or traded goods? And below.	Mexico USA	0.32 0.02

Researchers	Description Model	Sectors Included	Economies	Change in Economic Welfare; Percent of Annual GDP
Brown, Deardorff & Stern (1992)	Ex-ante, CGE, imperfect competition with differentiated products, increasing returns to scale, inter-industry flows. 1989.	23 trade goods sectors, 6 non-trade goods sectors. Capital and labor perfectly mobile between sectors but internationally mobile.	Canada Mexico USA Rest of World	0.70 1.60 0.10 (0.00)
Roland-Horst, Reinert & Shiells (1992, 1994)	Ex-ante, CGE, imperfect competition with differentiated products, increasing returns to scale, inter-industry flows. 1988.	26 sector aggregation, with 20 tradable sectors. Capital and labor domestically mobile between sectors but internationally immobile.	Canada Mexico USA	10.57 3.38 2.07
ASEAN Free Trade Area (AFTA)				
De Rosa (1995)	Ex-ante, CGE, perfect competition with differentiated products, constant returns to scale and inter-industry flows. 1988.	27 sectors including a non-traded sector. Capital specific to individual sectors; labor mobile between sectors. All primary factors internationally immobile.	Indonesia Malaysia Philippines Singapore Thailand	0.23 1.30 0.41 3.86 0.56
Lewis & Robinson (1996)	Ex-ante, CGE, perfect competition with differentiated products, constant returns to scale and inter-industry flows. 1992	12 sectors, including one service sector. Primary factors (capital, land two types of labor) domestically mobile between sectors but internationally immobile	Indonesia Malaysia, Singapore Philippines Thailand China Korea Chinese Taipei Japan USA EU	0.03 0.04 0.14 0.18 (0.01) 0.00 0.00 0.00 0.00 0.00
MERCOSUR				
Flores (1997)	Ex ante, CGE, imperfect competition with differentiated products, increasing returns to scale and inter-industry flows patterned after GSV (1992). 1990.	9 sectors with 5 sectors identified as imperfectly competing. Capital (and labor?) domestically mobile and within MERCOSUR.	Brazil Argentina NAFTA Mexico USA Chile	0.10 0.11 (0.00) 0.00 (0.00)

Researchers	Description Model	Sectors Included	Economies	Change in Economic Welfare; Percent of Annual GDP
Chilean Accession to MERCOSUR, Nafta				
Hinojosa-Ojeda, Lewis, & Robinson (1997)	Ex-ante, CGE, perfect competition with differentiated products, constant returns to scale and inter-industry flows, 1989.	10 tradable sectors, including 1 service sector. 4 primary factors of 11 sectors, including service sector. Capital, land, 4 types of labor domestically mobile between sectors; unskilled labor mobile between the US and Mexico.	MERCOSUR Accession Chile 0.06 Argentina 0.11 Brazil 0.10 Nafta USA 0.00 Mexico 0.21 Nafta Accession Chile 0.08 USA 0.00 Mexico 0.22 MERCOSUR Argentina 0.11 Brazil 0.10	
Harrison, Rutherford & Tarr (1997)	Ex-ante, CGE, perfect competition with differentiated products, constant returns to scale & inter-industry flows. 1994	24 sector aggregation, including 3 non-trade goods sectors. Primary factors (capital, labor, land) domestically mobile. Capital specific to individual sectors; labor mobile between sectors. All primary factors internationally immobile.	Chile: MERCOSUR Accession Chile: NAFTA Accession Chile: UTR* 8% 0.02 0% (0.26)	(0.62)
Asia Pacific Free Trade Area				
Lewis, Robinson & Wang (1995)	Ex-ante, CGE, perfect competition with differentiated products, constant returns to scale, inter-industry flows, labor migration. 1990.	Production factors (capital, land, two types of labor) domestically mobile between sectors but internationally immobile.	USA 0.04 Japan 0.74 China 0.13 ASEAN-4 0.36 Asian NIEs 2.44 Rest of world EU 0.05	
Western Hemisphere Free Trade Area				
Hinojosa-Ojeda, Lewis & Robinson (1997)	Ex-ante, CGE, perfect competition with differentiated	11 sectors, including services sector. Capital, land, 4 types of labor	USA 0.00 Mexico 0.23 Argentina 0.13	

Researchers	Description Model	Sectors Included	Economies	Change in Economic Welfare; Percent of Annual GDP
	products, constant returns to scale, inter-industry flows, labor migration. 1990.	domestically mobile between sectors. Unskilled labor mobile between the US and Mexico.	Brazil Chile	0.12 0.14

Note: UTR (unilateral trade liberalization): tariffs reduced to optimum level estimated at about 8%.
Source: Table 3 of De Rosa (1998); Roland-Horst, Reinert & Shiells (1994).

2.5 Conclusion

This chapter has sought to address the issue of whether or not the new regionalism is a building block for multilateralism based on WTO rules. The questions posed here are not new to APEC, having been raised in at least two previous reports of the Economic Committee (1997a, b). The objective of this chapter is quite modest. The emerging recovery from the Asian financial crisis has opened up a good opportunity to resume in-depth discussions of trade and investment issues and stay abreast of APEC's vision of open regionalism based on "trade and investment liberalization and facilitation" and on "economic and technical cooperation."

The work here has not attempted to introduce new issues about RTAs. It merely reviewed and tried to update existing issues. The motivation for the update on the debate about RTAs stems mainly from the expectation that RTAs are here to stay, judging by the new initiatives being announced. In APEC, the concern is how to make sure that existing and prospective RTAs, particularly, when some of its member economies are involved, promote open multilateral trade.

The assessment done here shares the main conclusion of other writers and of the EC reports cited above: under certain conditions, the dynamic trade-creating and investment-inducing impacts of RTAs outweigh the trade diversion effects.

One crucial condition is compliance with the provisions of Article XXIV. To reiterate, RTAs must cover "substantially all trade" items, with duties and other restrictive regulation of commerce removed; moreover, the RTA must have a schedule for achieving free trade among members and must not increase protection against non-members. The challenge for the WTO, through the Committee on Regional Trade Agreements (CRTA), is to ensure convergence between RTAs and the multilateral trading system.

In line with the above, it is important for RTAs to have a comprehensive coverage, to include not only trade in industrial goods, but also in services and agriculture. The timetable for the realization of free trade must avoid creating any incentive to members to reverse domestic policy reforms. If there are excluded commodities, it is preferable to spell them out in a negative list, but with a schedule for their eventual inclusion into the trade liberalization agreement. Related to this, RTAs must aim for deeper integration, particularly, in relation to investment, competition policy, and mutual recognition of standards. Moreover, RTA members must aim to minimize contingent protection. In

addition, an openness of RTAs to non-members that gives rise to an ever-expanding trade bloc is essential. Periodic review of any agreement is material.

While these conditions are necessary, they are not sufficient. They should be underpinned by market-oriented policy reforms designed for competition. In this connection, unilateral tariff policy reforms taken before joining an RTA must not be reversed after entry.

Finally, as an agenda for future research, theoretical and empirical studies on the expected dynamic gains from RTAs are helpful for making policy choices. The latter are especially helped if the quantitative work based on the computable general equilibrium models that are prevalent at this stage can be supplemented by empirical impact studies of RTAs.

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AUSTRALIA

The Australian economy continued to perform strongly in 1999, and is entering its ninth calendar year of uninterrupted positive growth. The strong economic growth in 1999 was accompanied by solid gains in employment and continued low inflation.

GROSS DOMESTIC PRODUCT

Real GDP increased by 4.4 percent in 1999 following a growth of 5.2 percent in 1998. Growth has been consistently strong, with Australia recording its 11th consecutive quarter of through-the-year growth in the fourth quarter of 1999 at more than 4 percent.

Business investment rose by a 0.2 percent in 1999, representing a relatively flat level that reflected the maturity of the investment cycle after seven years of uninterrupted growth, with Olympics-related construction nearing completion and uncertainty in the resources sector caused by low commodity prices.

Following two years of strong growth, dwelling investment increased by 5.4 percent in 1999, reflecting continuing high levels of affordability, moderately supportive demographic factors and ongoing expenditure on alterations and additions.

Private consumption rose from 4.1 percent in 1998 to 4.6 percent in 1999, the growth of which is likely to have reflected the effects of low interest rates, solid employment growth and rising household wealth.

INFLATION

Robust productivity growth, moderate wages increase, heightened competitive pressures and a rise in the value of the Australian dollar all contributed to an exceptionally good inflation performance in 1999, with the consumer price index (CPI) rising by 1.8 percent through the year in the last quarter of 1999 (and by 1.5 percent in year average terms).

EMPLOYMENT

Employment grew by 2.9 percent in 1999, with the unemployment rate continuing to fall and reaching 7.0 percent by December 1999.

Wages, as measured by average weekly ordinary-time earnings for full-time adults, rose by 3.0 percent through the year up to December 1999 but the average weekly earnings (all employees) grew by a mere 1.6 percent in the same period.

CURRENT ACCOUNT

The current account deficit increased from 5.0 percent of GDP in 1998 to 5.7 percent of GDP in 1999 at A\$34.9 billion. This reflected a fall in the balance of trade despite moderate export growth, a slight fall in the terms of trade (after a significant fall in 1998) as well as a continued strength in imports given strong domestic demand. Export demand remained subdued until the second half of 1999 with Australian exports directed mostly away from East Asian economies and toward faster-growing economies. This trend,

however, appeared to have changed as the East Asian economies started to recover from the financial crisis by late 1998.

In the meantime, while the current account deficit rose as a percentage of GDP in 1999, the net income deficit remained stable at 3.0 percent of GDP.

FOREIGN INVESTMENT

Net foreign debt was 39.8 percent of GDP (or US\$159.5 billion) at the end of December 1999, below the peak of 41.9 percent at the end of September 1998. By end of December 1999, the public sector accounted for approximately 11 percent of this total, with the remaining 89 percent owed by private sector borrowers. The build-up in foreign debt is a result of ongoing current account deficits reflecting a structural saving-investment imbalance. The Government's medium-term fiscal strategy of achieving fiscal balance on average over the course of the economic cycle is directed at addressing the issue of unsustainable government borrowing, one of the underlying contributors to continuing current account deficits.

Gross foreign debt was 61.3 percent of GDP (or US\$245.4 billion) at the end of December 1999 while foreign direct investment in Australia was 29.6 percent of GDP (or US\$118.6 billion) in the same period.

EXCHANGE RATE

Since 1983, Australia has had a floating exchange rate. The Reserve Bank may undertake foreign exchange market operations when the market threatens to become excessively volatile or when the exchange rate has clearly 'overshot' a level consistent with underlying economic fundamentals. However, these operations are invariably aimed at stabilising market conditions and are not undertaken in accordance with a specific exchange rate target.

The Australian dollar appreciated (in nominal terms) by 2.5 percent against the US dollar and depreciated by 10.7 percent against the Japanese yen in 1999. On a trade-weighted basis, the Australian dollar depreciated by around 0.9 percent in 1999, with falls against most major currencies, including those of Australia's Asian (non-Japan) trading partners.

FISCAL POLICY

Total general government net lending returned to surplus on a cash basis in the 1997-98 financial year and has remained so since then (data are not available on a calendar year basis). This improvement has been mainly due to the elimination of the large Commonwealth Government fiscal deficits recorded in the first half of the 1990s.

In 2000-01, the Commonwealth Government is expecting to achieve a fiscal surplus of 0.8 percent of GDP on an accrual basis (0.4 percent of GDP on an underlying cash basis). This is lower than the fiscal surplus of 1.5 percent of GDP (1.2 percent of GDP on an underlying cash basis) expected to be achieved in 1999-2000, reflecting the budgetary cost of the major taxation reform package to be introduced in the coming year.

MONETARY POLICY

The Reserve Bank of Australia has the primary responsibility for the conduct of monetary policy. The formal objectives of monetary policy require the Reserve Bank Board to conduct monetary policy in a way that will best contribute to price (currency) stability, the maintenance of full employment, and the economic prosperity and welfare of the people of Australia. Price stability is regarded as a precondition for achieving the last two objectives and in pursuit of this goal, the Reserve Bank has agreed to a commitment with the government to hold inflation to between 2 and 3 percent over the cycle.

To fulfill this commitment, the Reserve Bank targets a publicly announced overnight cash rate (the intermediate objective) determined by the Reserve Bank Board. The Reserve Bank Board does not target intermediate financial aggregates.

The most recent interest rate cycle troughed at 4.75 percent in December 1998, with rates held steady at this level until November 1999. At this time, the Reserve Bank acted preemptively against inflationary pressures and tightened monetary policy by 25 basis points – taking the target cash rate to 5 percent.

During calendar year 1999, real short-term interest rates (90-day bank bills adjusted for underlying inflation) rose by around 45 basis points, to end the year at around 3½ percent. This reflected an increase in nominal short-term yields of almost 90 points (partly attributable to the official interest rate rise) and a modest rise in inflation. Real long-term bond rates (10-year bonds adjusted for underlying inflation) rose by some 120 basis points to end the year at around 4½ percent, mainly reflecting an increase in nominal rates of around 160 points over the year.

MEDIUM-TERM OUTLOOK¹

The outlook for the Australian economy remains bright as it expects to experience a continued solid growth and relatively low inflation.

However, following a very strong economic growth over the past few years, growth is expected to be more moderate, from around 4¼ percent in 1999-2000 to 3¾ percent in 2000-01.

A significant rebalancing of the components of growth underpins the moderation in growth expected in 2000-01. Domestic demand is expected to grow at a slower pace than in recent years, reflecting a subdued consumption growth (as wealth effects from house price and share price movements stabilise), an unwinding of a net bring-forward of expenditure ahead of *The New Tax System*, and the impact of recent increases in interest rates (since November 1999, there have been four subsequent rises in the target cash rate, bringing it to 6.25 percent by August 2000).

Partly offsetting the slowing in some elements of domestic demand will be the stronger growth in business investment and a significant strengthening in exports. Increased

¹ Forecasts for the Australian economy are only available on a financial year (July to June) basis.

business investment will be supported by the beneficial impact of *The New Tax System* on the price of investment goods and business costs, a stronger outlook for the world economy and relatively high levels of capacity utilisation. Faster world economic growth, combined with some moderation in domestic demand and a boost to services exports from the Olympics, will result in net exports making a positive contribution to growth in 2000-01. The overall decline in the Australian exchange rate during the course of 1999-2000 will also contribute to a stronger net export performance in 2000-01.

The current account deficit (CAD) is forecast to average $4\frac{3}{4}$ percent of GDP in 2000-01, down from $5\frac{1}{2}$ percent of GDP in 1999-2000. The expected decline in the CAD reflects the impact on net export volumes and the terms of trade of the stronger world economy, along with some moderation in the rate of growth of domestic demand.

Employment growth is forecast to remain robust at $2\frac{1}{4}$ percent in 2000-01, following a growth of around $2\frac{3}{4}$ percent in 1999-2000. The unemployment rate is expected to fall further, reaching $6\frac{1}{4}$ percent by the 2nd quarter of 2001.

Inflation is expected to be around $2\frac{1}{2}$ percent in year-average terms in 1999-2000. The slight increase from the very low outcomes of previous years mainly reflects the impact of higher world oil prices over calendar year 1999 and in the early months of 2000. In 2000-01, ongoing inflation (that is, leaving aside the impact on prices of the changes in indirect taxes) is forecast to be around $2\frac{1}{2}$ percent until the 2nd quarter of 2001.

Taking together the estimate of ongoing inflation and the impact of *The New Tax System* on prices, the CPI is forecast to rise by around $5\frac{1}{4}$ percent through the year up to the 2nd quarter of 2001. Households will be more than compensated for the one-off price impact of indirect tax reform via income tax cuts and increases in welfare payments. The changes to indirect tax arrangements are therefore not expected to have any significant impact on wage settlements or ongoing inflationary pressure.

POLICIES, STRATEGIES AND ADJUSTMENT MEASURES

To be sure, Australia's ability to 'weather the (Asian financial crisis) storm' was the result of the sound macroeconomic policies and structural reforms that have been gradually put in place over time rather than an element of luck. The key aspects of Australia's reform process, which supported the economy through the crisis, include:

- The credibility of Australia's fiscal policy has been improved by the adoption of a clearly articulated and demonstrated medium-term framework—to achieve underlying balance, on average, over the economic cycle—in addition to the legislated Charter of Budget Honesty.

Consistent with this objective, the budget is forecast to remain in surplus, the fourth surplus in a row. This outcome has been achieved while delivering landmark tax reform, including income tax cuts, and a range of high priority spending initiatives.

- The Government has also strongly supported the Reserve Bank's low inflation target and its independence in setting monetary policy. Monetary policy credibility, together with a more competitive Australian economy, has kept inflation low

despite the significant decline in the Australian dollar that accompanied the crisis in Asia.

- During the period of considerable uncertainty in the regional financial markets, the stability, integrity and efficiency of the Australian financial sector was critical to the performance of the economy. Recent reforms, including those that are being implemented through the Wallis Inquiry and the Corporate Law Reform Program, are aimed at maintaining a sound regulatory foundation for well-functioning markets, without compromising efficiency or consumer protection.
- Ongoing structural reforms, including those in labour and financial markets, have produced a more flexible and productive economy capable of responding to the Asian crisis. This improved flexibility was demonstrated by the capacity of Australian exporters to diversify their sales outside of the major export markets in Asia to other more strongly growing economies during the Asian crisis.

This policy framework was fundamental to the economy's resilience against the backdrop of the Asian financial crisis. It allowed foreign investors' confidence in Australia to be maintained, facilitating an orderly depreciation of the dollar and allowing interest rates to remain low.

One major lesson stemming from the Asian crisis is the importance of sound macroeconomic policies and ongoing structural reforms. In view of this, Australia is pushing ahead with a range of reforms even as it had enjoyed very good economic outcomes in recent years. These reforms include:

- Through the historic *the New Tax System* legislation passed in June 1999 and announced business tax reforms, the Government is reforming the tax system to make it fairer and simpler. The reform of Australia's taxation system will contribute to raising the economy's growth potential through more efficient resource allocation and better incentives.

The existing tax system is a significant impediment to improving Australia's economic position. The GST package will thus significantly lower income tax rates, thereby improving incentives to work and save. The Wholesale Sales Tax system will be replaced with a tax regime that reduces business costs and encourages productive investment.

Business tax reform will be directed at achieving a taxation system that reduces distortions to business decisions and provides a competitive regime for attracting international investment. Overall reform of the tax system will contribute to raising the economy's growth potential through improved resource allocation and providing better incentives.

- Continuing reform of the labour market. Despite recent falls in the unemployment rate, Australia is continuing to reduce the barriers to job creation and active participation in employment.

BRUNEI DARUSSALAM

GROSS DOMESTIC PRODUCT

In 1999, Brunei Darussalam's economy improved, as it grew at 2.5 percent compared to – 4 percent in the previous year. GDP growth was due to positive developments in both the oil and government sectors especially during the second half of 1999. The crude oil price reached its highest level in a decade and this has been accompanied by an increase in production levels.

The mining, manufacturing and quarrying sector, mainly oil and gas, continued to contribute about 50 percent of total output. The number and production of non-oil manufacturing activities have, however, shown some increase in 1999. The services sector, comprised primarily of government services, declined as contributions from private/business sector activities such as retail, and wholesale trade, ownership of dwellings and finance were adversely affected by government spending cuts.

The construction sector was worst hit. The number of government infrastructure projects and commercial and housing buildings declined sharply due to excess supply and very low demand, coupled with difficulties in getting financing.

The contribution from agriculture, forestry and fisheries, as in previous years, is still very insignificant at less than 4 percent of the GDP, despite achieving some improvement. Many of the improvements of the last few years have, however, been adversely affected by the haze problem.

INFLATION

In 1999, average annual CPI contracted to -0.1 percent, a slight increase from the -0.4 percent recorded in 1998. For the most part, price developments reflected the combined effects of declines in the US dollar import prices of food, manufactured products, and machinery and transport equipment and fluctuations in the currencies of import source economies. In particular, the appreciation of the Brunei dollar against the currencies of neighboring economies affected by the Asian Financial Crisis, such as the Malaysian ringit, Indonesian rupiah, Philippine peso and Thai baht, was offset by its depreciation against the US dollar, pound sterling, the yen, and the major European currencies, especially during the first half of the year. This helped moderate imported inflationary pressures as ASEAN members account for 45 percent of Brunei Darussalam's total imports while the US, Japan and Europe account for 39 percent.

EMPLOYMENT

Total population of Brunei Darussalam in 1999 was estimated to be 331,000 or growing at 2.4 percent. The labor force was about 135,000 or growing at 2 percent. A significant portion of the labour force consisted of migrant workers, although the number has notably declined as a consequence of the fiscal consolidation measures adopted by the government in recent years and the impact from the collapse of a large private company.

The labour force participation for women has increased significantly from 29.5 percent in 1986 to 52.3 percent in 1999. Of growing concern is the fact that over 6,000 or so persons, especially youths, are still actively seeking jobs. To address this concern, the government has continued to set up a number of technical and vocational training institutions, local handicrafts for cottage industries and a Resource Center for budding entrepreneurs with inputs also coming from the private/business sector.

TRADE ACCOUNTS

Hydrocarbon exports and the steady accumulation of long-term foreign assets over many years have provided Brunei Darussalam with a comfortable external position, facilitating the maintenance of a liberal exchange and trade system. However, in recent years, both trade and current account balances have deteriorated (in terms of GDP) as imports rose sharply while exports remained stagnant. Japan is the major export market while imports have largely come from ASEAN countries.

Although the current account remained in substantial surplus throughout the period, the surplus showed a declining trend, falling from 47.4 percent of GDP in 1995 to 46.2 percent in 1999 following reduced earnings from petroleum. In 1999, the trade surplus improved by almost double that of the previous year's level, mainly due to the effects of the increase in production and prices of oil and gas.

Portfolio and direct investment inflows have risen in recent years. Recorded inflows, however, are dwarfed by long-term capital outflows which are derived as a residual in the balance of payments compilation, combining direct placements and reinvested earnings. Short-term capital provided net financing for many years. In placing their structural excess liquidity abroad, commercial banks in Brunei contributed significantly to both outward portfolio investment and short-term lending in most years. In 1999, direct and portfolio investments were estimated to have decreased by more than 10 percent.

FISCAL POLICY

The government continued to tighten its fiscal outlay, following the fall in revenues of the hydrocarbon sector since 1997 as well as of the non-oil private sectors due to the slowdown of the economy. Public expenditures fell by about 37 percent of the level of the previous year. Overall expenditures also remained below the 1998 level by about 6.4 percent and improved the budget deficit by 31.5 percent from US\$1,188 million to US\$814 million.

MONETARY POLICY

On the average, the movement of the Brunei dollar was quite stable at around US\$1=B\$1.7. -Aggregate bank lending in 1999 continued to decline, reflecting the sharp and widespread downturn in the domestic non-oil and gas activities. The prime lending rate during the period was maintained at 6.25 percent. Currency in circulation in 1999 was around US\$713.6 million, up by 13.8 percent from the previous level. Brunei Darussalam has no central bank. Thus, the trend of interest rates follows that of Singapore since the two economies' currencies are at par.

MEDIUM-TERM OUTLOOK

The performance of the economy in the next couple of years, particularly in 2000, depends very much on the developments in both the hydrocarbon sector and the government's contributions. The recent trend in production, prices and exports for both oil and gas has shown improvements and is expected to bring in additional revenues. The tight fiscal situation is expected to remain—despite this improvement, with the view of balancing the budget. In the year 2000, GDP growth is estimated to be between 3 and 3.5 percent while inflation is expected to be around 1 percent.

Some of the important factors which could/will significantly influence the macroeconomic performance of the economy in the medium-term are:

- The implementation of recommendations of Brunei Darussalam's Economic Council (BDEC) on measures aimed at economic recovery;
- The impact of commercialization, corporatization and privatization of some government activities;
- The improvement of the business and investment climate to encourage foreign direct investments (FDI);
- The establishment of Brunei Darussalam as an International Financial Centre (BIFC); and
- The production, price levels and exchange rates of oil and gas exports with emphasis on maintaining the stability of oil prices

CHILE

The effects of the Asian financial crisis, along with the impact of the *El Niño* phenomenon and the remarkable drop in prices of its main export commodities, were reflected in the economic performance of Chile last year. The crisis and the severe adjustments in economic activity that followed, however, are now gone and Chile has started its recovery, albeit at a slower pace than desired.

REAL GROSS DOMESTIC PRODUCT (GDP)

Despite the 1.1 percent contraction of the GDP in 1999, the Chilean economy started to recover in the second quarter and, more clearly, in the second half of 1999. Both external and internal threats have been removed, allowing the economy to return to its long-term growth trend.

The most affected sectors were commerce and construction, which contracted by 3.5 percent and 10 percent, respectively. In expenditure terms, hardest hit was gross capital formation, which suffered a 17.4 percent reduction, caused mainly by a 35.5 percent decline in capital assets imports. Notwithstanding this, some sectors showed positive performance, e.g., mining (+16.2 percent), housing (+2.9 percent), and transport and communications (+2.7 percent).

Recovery began in September 1999, with a 0.7 percent increase of the IMACEC (Monthly Indicator of Economic Activity) compared to the same month of the previous year. Since then, the IMACEC has shown only positive figures, with the greatest increase since the beginning of the recovery registered in July at 8.1 percent.

INFLATION

Inflation in 1999 was 2.3 percent, which is lower than the Central Bank target and continued the declining trend of previous years. This is explained mainly by a 10 percent decrease in internal demand, which started to increase during the year but did not create inflationary pressures.

As a consequence of the economic recovery and the continued increases in international oil prices, inflation in 2000 will be higher than in the previous year. Prices remain stable at around 3 percent and the Central Bank has set a range of between 2 percent and 4 percent as the medium-term inflation goal. Ampleness of capacity in internal markets will be the main factor to hold down inflationary pressures during the next two years, compensating for the greater push from demand and imported prices.

These limits are signals for the Central Bank not to modify its monetary policy so long as the consumer price index remains within this range.

EMPLOYMENT

Unemployment reached its highest rate for the nineties in 1999, with the average reaching 9.7 percent and peaking at 11.5 percent in the moving quarter ending August. Said average

rate was higher than the average level of 7.3 percent posted during the nineties. The economic recovery and government policies have, however, reduced this rate to 8.5 percent during the moving quarter ending April 2000 and all relevant indicators show Chile should gradually recover and return to its previous unemployment levels.

TRADE ACCOUNTS

The current account deficit declined from 5.7 percent of GDP in 1998 to 0.1 percent of GDP in 1999 as a result of imports contraction, exports expansion and deterioration in terms of trade. Merchandise trade registered a surplus of US\$1,664 million, while trade in services recorded a deficit of US\$2,196 million (financial and non-financial).

Imports contracted by 19.6 percent in 1999 over the previous year, while exports rose by 5.3 percent in the same period.

Meanwhile, the capital account deficit stood at 0.1 percent of GDP as it was strongly influenced by the first quarter situation. The deficit was due to a high increase of Chilean investments abroad, reduction on mid- and long-term loans, and short-term capital outflows.

GROSS EXTERNAL DEBT

Foreign debt reached US\$34 billion in 1999, representing almost 50 percent of GDP and an increase of 7.8 percent over the previous year. Most of the amount was mid- and long-term liabilities, which account for 88.5 percent of total foreign debt.

As to the business/private sector, its debt increased by 9.1 percent, representing about 82.9 percent of foreign debt. On the other hand, the public sector debt increased by only 2.0 percent.

EXCHANGE RATE

In September 1999, after widening the exchange rate band, the Central Bank decided to indefinitely suspend the limits of the band, which has the practical effect of moving to a floating regime. This decision was based on the greater stability of financial markets (internal and external) and on the desire to allow bigger and better possibilities for portfolio diversification, risk coverage and inflationary control.

The national currency, the peso, depreciated by 5.5 percent in real terms in 1999, breaking the appreciation trend of the last decade. However, this trend has been reversed since September, and the peso has appreciated in real terms by 0.5 percent from September to June 2000.

The nominal exchange rate is expected to evolve over an intermediate path between that implicit in future prices and the one compatible with a stable real exchange rate. That means a real exchange rate depreciation of around 2 to 3 percent within the projection line with respect to the observed value of the first quarter of 2000.

FISCAL POLICY

In 1999, fiscal policy had an expansionary effect over demand as a way of supporting economic recovery. As part of its recovery policy, the government implemented job-creation programs and tax incentives for new house acquisitions.

This expansionary policy and the reduction of fiscal incomes as a result of economic cycle contraction led to a fiscal deficit of 1.5 percent for the first time in years. However, this deficit should be reversed by this year due to an increase in fiscal revenues caused by privatization, economic growth, and the strong political commitment of the economic authorities to achieve a structural surplus of 1 percent by the end of next year. This evolution is clear in the Budget 2000 Law, which imposes an upper limit of 3.3 percent for government expenditure growth. If the tax burden remains unperturbed, a government expenditure growth rate of less than 1 billion pesos will be needed. For this reason, fiscal policy is expected to be very tight during the current and coming years.

MONETARY POLICY

Monetary policy was also expansionary in 1999. The monetary stance was substantially reduced during the first half of 1999, reaching 5 percent in June. This year, the Central Bank has raised the level twice (by 0.25 percent each time), increases that were made to avoid transitory cost pressures like those linked to oil prices, to stabilize the inflationary trend and to meet the expectations of economic agents. At the end of August 2000, the Central Bank decided to return to the monetary rate levels that prevailed at the end of last year (5 percent), due to the slow reactivation process in internal demand in recent months.

MEDIUM-TERM OUTLOOK

The Chilean economy has benefited from firmer global activity, a turnaround in primary commodity prices, a relatively low interest rate at home, eased fiscal stance, growing confidence, and solid economic fundamentals. All these elements will confirm a clear upswing in economic activity in the next months.

Moreover, Chilean macroeconomic policy is being reviewed in the light of recent experiences. Fiscal policy is clearly committed to restoring in the short run the strength that showed for more than a decade. Monetary policy has adopted a more transparent and forward-looking framework by improving the inflation target scheme. The flexible exchange rate regime is functioning as expected, with continuous low inflation and deeper financial markets offering adequate hedging mechanisms. The financial system remains sound, resting on well-capitalized banks, strong management and supervision. Finally, the international financial integration continues as a gradual process that needs to be carefully monitored.

THE PEOPLE'S REPUBLIC OF CHINA

In 1999, China's economy maintained its growth momentum, registering an enhancement in quality as well as in benefits.

GROSS DOMESTIC PRODUCT (GDP)

China's GDP reached US\$991.07 billion in 1999, up by 7.1 percent over the previous year's level. Agricultural production increased continuously on the whole, showing the progress made in the adjustment of the planting structure. The capacity to combat natural adversities was enhanced further. As a result, grain production rose to 500 million tons.

In 1999, industrial production increased steadily, with the value-added of the whole sector hitting US\$427.05 billion, up by 8.5 percent over the 1998 level. All in all, the state-owned enterprises and state holding companies managed to reap profits amounting to US\$11.68 billion, up by 77.7 percent, the highest level in the last five years.

The investment structure continued to improve, and so did the quality of projects. In 1999, investment in fixed assets hit US\$360.85 billion, up by 5.2 percent over the year before. Investments by the state and other economic sectors reached US\$9.71 billion in the primary industries (inclusive of the water conservancy industry), up by 22.6 percent over the 1998 level; US\$86.56 billion in the secondary industries, down by 0.9 percent; and US\$166.05 billion in the tertiary industries, up by 9.3 percent.

In 1999, as a result of the combined effects of a number of factors such as the increase by the government of the income of low- and middle-income residents, the rise in consumer credit, the abolition of policies intended to prohibit consumption, and the successive lowering of interest rates by banks, sales in the domestic market were stable on the whole and showed signs of revitalization. Total retail sales of consumer goods reached US\$376.06 billion, up by 6.8 percent over the year before, or by 10.1 percent in real terms, given the falling prices. Of the total, US\$230.60 billion represented retail sales of consumer goods in cities, up by 7.1 percent, and US\$145.46 billion constituted retail sales at the economy's level and below, up by 6.3 percent over the previous year's level.

The livelihood of urban and rural residents continued to improve. Their income rose noticeably because the government adopted measures to provide basic living allowance to the laid-off workers of state-owned enterprises, insurance to the unemployed, and a minimum living allowance to urban and rural residents. Higher pensions were also offered to retired personnel of government departments, undertakings and enterprises. The per capita disposable income of urban and rural residents stood at US\$707.06, up by 9.3 percent over the year before, given the falling prices. However, the growth of the income of peasants slowed down, with the per capita net income of rural residents reaching US\$266.93, which was higher by 3.8 percent, because of the fall in prices, but lower by 0.5 percentage point in real terms, than the previous year's level. Tourism became fashionable, with the number of tourists reaching 719 million, up by 3.6 percent over the year before, and the per capita tourist expenses reaching US\$27.42.

In 2000, China's economy has been steadily growing and its growth rate is expected to hit 7.5 percent, reversing the downward trend of the past several years. GDP grew 8.2 percent

year-on-year to reach US\$475.8 billion during the first six months of 2000. Rapid growth in the industrial and service sectors spurred the GDP surge. China reported US\$257.4 billion in total industrial output for the first six months of the year, an increase of 9.7 percent over the same period in 1999. Total output of the service sector reached US\$164.2 billion during the period, a year-on-year increase of 8.1 percent.

The economy's consumer goods market was quite active during the first six months. Retail sales of consumer goods reached US\$195.8 billion during the period, an increase of 10.1 percent over the same period in 1999.

Due to the economy's active fiscal policy, fixed assets investment grew steadily by 11 percent year-on-year to reach US\$122.6 billion. Of that total, the state-owned sector contributed US\$90.8 billion, up 12.1 percent.

In the first half of 2000, exports increased 38.3 percent year-on-year to US\$114.5 billion. Imports grew by 36.2 percent to reach US\$102.1 billion, allowing China to enjoy a trade surplus of US\$12.4 billion, which is US\$4.4 billion higher than the surplus in the same period last year.

INFLATION

In 1999, the central government pursued a series of policies to enlarge demand, which resulted in prices falling more slowly. However, the pressure of deflation could still be felt, and for two consecutive years, negative growth of the inflation rate was registered as the general price level continued to come down. With prices of most commodities lower than the year before, the general levels of the residents' consumer price index (CPI) and retail prices dropped by 1.4 percent and 3 percent, respectively, from the 1998 levels.

In 2000, the CPI edged up by a tenth of a percent in the first half of the year, a sign of improvement following repeated falls in the past two years.

EMPLOYMENT

The government stepped up efforts to increase employment opportunities in 1999. At the year-end, the number of employed totaled 705.86 million, up by 6.29 million over the previous year's level. The number of employed in urban areas was 210.14 million, up by 3.36 million, and the number of personnel employed by private enterprises and individual proprietors was 39.4 million, up by 7.08 million.

The re-employment program made new headway. In 1999, an additional 5.64 million staff and workers were laid off in state-owned enterprises, but 4.92 million of them were re-employed through various channels. At the year-end, the laid-off staff and workers totaled 6.5 million, 400,000 more than at the end of the previous year. The registered rate of unemployment in urban areas stood at 3.1 percent, on a par with that of the previous year.

BALANCE OF PAYMENTS

China's imports and exports rose relatively rapidly, and the quality of foreign investment utilization continued to improve. In the second half of 1999, following the reversion of the falling trend, China's exports rose at an accelerated pace. Total imports and exports in

1999 hit US\$353.2 billion, up by 11.3 percent over the 1998 level. Exports reached US\$194.7 billion, up by 6.1 percent, while imports amounted to US\$158.5 billion, up by 18.2 percent, resulting in a trade surplus of US\$36.2 billion. The export structure improved with exports of electrical and mechanical equipment rising by 14.7 percent, registering a net growth of US\$9.9 billion, and accounting for 88 percent of the net growth of exports.

The capital account surplus reached US\$0.79 billion while the balance of payments surplus stood at US\$16.45 billion.

The foreign investment actually utilized amounted to US\$56.3 billion, down by 3.9 percent from the previous year. The contractual foreign investment amounted to US\$45.4 billion, of which US\$40.4 billion was foreign direct investment, down by 11.4 percent, but still taking the leading position among the developing economies. There was a remarkable increase in the number of capital and technology-intensive projects encouraged by the state; the scale of projects was larger; and there were more TNCs investing in China.

The number of international tourists increased, reaching a total of 72.80 million, up by 14.7 percent over the previous year.

In the first half of 2000, China's foreign trade kept an upbeat growth momentum with exports surging by 38.3 percent to US\$114.5 billion. Imports for the January-June period stood at US\$102.1 billion, up 36.2 percent year-on-year. Total trade surplus amounted to US\$12.4 billion, US\$4.4 billion more than the surplus in the same period of last year.

Foreign direct investment (FDI) in the first half of 2000 amounted to US\$17.17 billion, lower by 7.5 percent than the FDI recorded in the same period in 1999. However, the decline in FDI was less than the decline in 1999.

EXCHANGE RATE

The renminbi remained stable against the US dollar, and the exchange reserves continued to rise, reaching US\$154.7 billion at the year-end, US\$9.7 billion more than at the end of the previous year. The year-end exchange rate was 8.2793 yuan to 1 US dollar, down by 4 basis points from the previous year-end.

FOREIGN DEBT

By the end of 1999, China's registered foreign debt balance was US\$151.83 billion¹, up by US\$5.79 billion over the 1998 foreign debt balance. Long- and medium-term debts amounted to US\$136.65 billion, up by US\$7.95 billion over the previous year's level while short-term debts amounted to US\$15.18 billion, down by US\$2.16 billion from the previous year's total. New foreign borrowings in 1999 totaled US\$30.05 billion, while repayments of the principal and interest of foreign debts amounted to US\$30.99 billion.

¹ The figure does not include debts of Hong Kong SAR, Macao and Chinese Taipei.

FINANCIAL POLICY

The government made a significant decision to more vigorously enforce an active financial policy by adopting one measure after another, such as issuing a greater amount of treasury bonds, increasing investment and adjusting policies for income distribution as well as foreign trade and domestic taxation. All these resulted in an effective expansion of social demand, and ensured economic growth and social stability.

Revenues and expenditures increased rapidly. Revenues (excluding loan revenue) increased by 15.2 percent to reach US\$137.42 billion, while expenditures (excluding loan expenditure) reached US\$158.66 billion, up by 21.7 percent. Expenditures exceeded revenues by US\$21.25 billion, with a central financial deficit amounting to US\$21.70 billion, and a local surplus of US\$0.50 billion. In 1999, the treasury bonds issued by the central government amounted to US\$48.49 billion, of which US\$12.20 billion was used for investment. Of the amount used for investment, 60 percent was poured into the economy's middle and western regions.

MONETARY POLICY

Efforts were made to bring the financial policy into play. While the interest rate and the required deposit reserves rate were lowered, consumer credit and the central bank's loans to small- and medium-sized financial institutions were increased. Money supply was also appropriately increased. All these measures promoted domestic demand and economic growth.

At the end of 1999, M_2 , M_1 and M_0 rose by 14.7 percent, 17.7 percent and 20.1 percent, respectively. The year-end deposit balance of all financial institutions stood at US\$1,135.36 billion, an increase of US\$130.45 billion in the same year.

Strategies, Policies and Measures Adopted To Step Up Market Development, Take Precautions Against a Financial Crisis and Promote Sustainable Economic Growth

1. *To execute the strategy to regenerate the economy through science and technology:* The building up of the technology innovation system and the implementation of projects for knowledge innovation will be stepped up. The state will give support to the setting up of technological development centers at large state-owned enterprises, and encourage the development of the various forms of non-governmental technological enterprises as well as technology-oriented medium-sized and small businesses. The construction of state engineering research centers and bases for the commercialization of the fruits of scientific research is to be expedited, and important projects for high-tech industrialization are to be well organized. The state will concentrate its energy on projects to promote the development of new industries such as digital high-definition TV, wide-band and high-speed information networks, automation of industrial processes, aircraft for civil use, and satellites for civil use. It will also vigorously promote the use of information technology in the national economy, and accelerate the development of the information industry.

2. *To expedite the reform and development of education:* It is necessary to carry forward quality education in a holistic manner, to make the nine-year compulsory education universal, and to eliminate illiteracy among young and middle-aged people. In 2000, 120,000 postgraduate and 1.8 million undergraduate students are to be enrolled. Non-government organizations and individuals will be encouraged to run schools in various forms.
3. To enforce the "Go-West" strategy and promote coordinated regional economic developments.
4. To continue to pursue the active financial policy and to issue US\$12.08 billion worth of long-term treasury bonds to increase investment.
5. *To make use of various monetary policies to give vigorous financial support to economic development:* It is necessary to put more basic currency into circulation to increase money supply appropriately in the light of the needs of economic development. In 2000, M_2 is projected to rise by 14 to 15 percent and M_1 by 17 percent.
6. To suspend the levying of fixed assets investment orientation regulatory tax while enforcing the adjusted taxation policy to increase investment demand.
7. *To further reform the pricing system:* In 2000, the prices of public transportation as well as water supplied from water conservancy projects and to the cities will be raised appropriately. The electricity price structure will be adjusted by lowering the price of electricity used in rural areas; postage fees will be adjusted and telephone fees in the rural areas reduced; tuition fees will be reasonably adjusted; prices of pharmaceuticals and medical fees will be revised; and the rent for public housing and environmental protection fees will be raised. All these changes are aimed at promoting the development of basic industries and public utilities as well as increasing consumption by urban and rural residents.
8. To reduce the burden on enterprises by straightening out import and export taxes and lowering appropriately those charges which are on the high side; to adjust charges for housing construction to lighten the burden on housing purchasers.
9. To adopt measures to promote consumption demand such as extending consumption credit to individuals, lengthening the legal holidays and improving the consumption environment.
10. *To pay close attention to the work of converting debts into equity in some of the large and medium-sized state-owned enterprises:* The work must be geared to the transformation of the operating mechanism, adjustment of the structure and the improvement of management. To prevent creditor-dodging and debt-abrogation in disguised form and the loss of state-owned assets, it is necessary to adhere strictly to the requirements and to standardize the work procedure.
11. *To strengthen financial legislation and supervision:* In the light of the guiding principle of managing state and financial matters by law, financial legislation is to be expedited. In 1999, over 60 sets of rules and regulations were dealt with, such

as the revision of the "Accounting Law" and the formulation of the "Provisional Rules for Punishing Those Who Violate the Law or Regulations in Executing the Central Budget".

12. To actively promote the development of medium-sized and small enterprises as well as non-state-owned sectors, and to create new job opportunities.

MEDIUM-TERM OUTLOOK

The year 2000 is the turn of the century as well as the final year of the ninth five-year plan.

In this year, China will continue to execute a series of policies to push forward economic reform and development, focusing on the reform of state-owned enterprises, economic restructuring, technological advance and enlarging domestic demand. Efforts will be made to ensure that agriculture plays the role of the foundation of the economy, to restructure agriculture and rural areas, and to increase the income of peasants. With the reform of the state-owned enterprises as the key link, work will be done to turn losses into profits, and to introduce a modern corporate system. The active financial policy will be continued and monetary policy will be given full play. Through a combined use of macro regulatory measures such as tax and price, infrastructure construction, technical transformation and technological innovation are to be stepped up and consumption increased. China will open up further, increase its imports and exports, and raise the level of foreign investment utilization. Also, China will improve its social security system, step up the work to aid the poor and enhance people's livelihood. To ensure a rapid and healthy development of the national economy and an all-round progress of society, efforts to handle the relationships of reform, development and stability correctly will be continued.

The expected targets for 2000 are as follows:

Economic growth rate: 7.0 percent (approximately)

Increase in fixed assets investment: 10 percent (approximately)

CPI: moderately higher than 1999

Increase in total imports and exports: over 10 percent

Balance of payments: basically balanced

Central budgetary deficit: US\$27.77 billion

Money supply: US\$18.12 billion (approximately)

Registered unemployment rate in urban areas: 3.5 percent (approximately)

Natural growth rate of population: 0.92 percent

HONG KONG, CHINA

REAL GROSS DOMESTIC PRODUCT

The Hong Kong, China economy staged a sharp rebound in 1999, recovering robustly from the severe setback brought about by the earlier Asian financial turmoil. By the fourth quarter of 1999, the level of economic activity had already surpassed the previous peak in the third quarter of 1997. For 1999 as a whole, the GDP grew by 3.1 percent in real terms, in contrast to a 5.3 percent decline in 1998. Economic recovery has become more entrenched in 2000, with GDP attaining a double-digit growth of 12.5 percent in real terms in the first half of 2000 over a year earlier.

The recovery in 1999 was strongly export-led. Driven by the resurgence in demand in the East Asian markets as well as by sustained import absorption in the United States and Europe, exports of goods accelerated to double-digit growth in the second half of the year to give a 3.7 percent growth in real terms in 1999. Exports of services likewise picked up during the year, with a growth of 7.8 percent in real terms in 1999. On the back of continued brisk import demand both from within the region and in the conventional overseas markets, exports of goods surged further by 19.1 percent in real terms in the first half of 2000 from a year earlier. Exports of services also recorded an accelerated growth of 15.8 percent over the same period.

Locally, consumer spending turned around in the second quarter of 1999 and registered a growth of 0.8 percent in real terms for the year as a whole. Consumer spending picked up distinctly further to a growth of 7.0 percent in the first half of 2000 over a year earlier, upon sustained improvement in labour market conditions and increased overall income. As to investment spending, it resumed a positive growth of 5.1 percent in the first half of 2000 over a year earlier, reversing the 17.3 percent decline in 1999. The process of economic recovery has thus broadened to the domestic sector in 2000.

INFLATION

Consumer prices remained on a downtrend in the first eight months of 2000. But the decrease narrowed appreciably, from -5.3 percent in the beginning of the year to -2.7 percent in August in terms of the Composite Consumer Price Index (CPI). To a considerable extent, this was due to a firming of external commodity prices, and the hike in fuel oil price. Also, the pick-up in inflation in some of the major supplier economies contributed to this trend. On the domestic front, labour wages and property rentals had shown signs of bottoming out in more recent months, although in overall terms price pressure from domestic sources was still subdued. Amidst keen competition in the retail business, local retailers continued to give large discounts to promote sales. Also, there was a continued freeze in government fees and in a number of public utility charges.

EMPLOYMENT

Labour market conditions showed a visible improvement in the more recent months, as labour demands strengthened further while labour supplies slowed down. More specifically, having fallen for almost two years, total employment reverted to a small

growth in the fourth quarter of 1999 over a year earlier. The momentum continued into the first two quarters of 2000, with growth accelerating to 1.7 percent and 1.9 percent, in tandem with the strong revival in economic activity. Total labour supply on the other hand exhibited a completely different profile, with growth hovering at around 0.5 to 0.9 percent in the latter part of 1999 and in the first half of 2000, distinctly slower than the 1.4 – 1.9 percent growth in the early part of 1999. Total employment growth thus outpaced total labour force growth in the first two quarters of this year. This in turn contributed to a steady decline in the seasonally adjusted unemployment rate, from 6.0 percent at the end of 1999 to 4.9 percent in June – August 2000. Total unemployment likewise dropped, from 210,700 to 172,000 over the same period.

TRADE ACCOUNT

Exports of goods were still slack in the first half of 1999 but revived sharply in the second half of the year. In 1999, total exports of goods (comprising re-exports and domestic exports) reached HK\$1,349 billion (US\$174 billion), representing virtually no change in value terms. Imports of goods contracted by 3 percent in value terms to HK\$1,393 billion (US\$180 billion) in 1999, due to slack domestic demand. Taken together, the visible trade deficit narrowed to HK\$44 billion (US\$6 billion) in 1999, nearly halved from the deficit of HK\$ 81 billion (US\$11 billion) in 1998.

Exports of services staged a significant rebound in 1999. Apart from the sustained growth in inbound tourism, there was a surge in offshore trading activities amidst the distinct turnaround in export performance in China. Also exports of trade-related and other business services picked up along revived demand in the region. The invisible trade surplus thus expanded considerably to HK\$112 billion (US\$14 billion) in 1999. This, together with the already much reduced visible trade deficit, gave a substantial combined surplus of HK\$66 billion (US\$9 billion) in the year.

The global economic upswing continued to bolster Hong Kong, China's exports of goods and services in the first half of 2000. But import of goods also staged a sharp rebound along with the pick-up in domestic demand. The combined visible and invisible trade account nevertheless remained in surplus, at HK\$12 billion (US\$2 billion) in the first half of 2000.

EXTERNAL BALANCE OF PAYMENTS

The current account surplus improved to HK\$82 billion (US\$11 billion) or 6.6 percent of GDP in 1999, on the back of a much reduced visible trade deficit and a marked increase in invisible trade surplus amidst the recovery in regional demand. As the local economic situation progressively improved over the course of 1999, there were resumed investment flows into Hong Kong, China in the fourth quarter of 1999, amounting to HK\$43 billion (US\$5 billion) or 13.0 percent of GDP in that quarter. For 1999 as a whole, there was a net inflow of financial non-reserved assets of HK\$12 billion (US\$2 billion), equivalent to 0.9 percent of GDP in that year. Together with the large current account surplus, a balance of payments surplus of HK\$74 billion (US\$10 billion) equivalent to 6.0 percent of GDP was attained in 1999. Hong Kong, China's reserve assets correspondingly surged in that year. This reversed the situation in 1998, when an overall balance of payments deficit of HK\$54 billion (US\$7 billion) equivalent to 4.3 percent of GDP was recorded.

EXCHANGE RATE

The spot exchange rate of the Hong Kong dollar against the US dollar weakened marginally from 7.774 at the beginning of the year to 7.797 at end-July 2000. This was broadly in line with the movement of the Convertibility Undertaking Rate for the Aggregate Balance, which had moved from 7.750 by 1 pip per calendar day effective from 1 April 1999, and reached 7.800 on 12 August, where it will stay thereafter. As the US dollar strengthened against the European currencies and the Japanese yen, the trade-weighted Nominal Effective Exchange Rate Index of the Hong Kong dollar increased from 131.5 at end-1999 to 134.2 at end-August 2000.

FISCAL POLICY

The distinct pick-up in the economy in the second half of the 1999–2000 financial year helped boost government revenues, and resulted in a surplus of HK\$10 billion. Despite the economic downturn, expenditure growth was maintained in 1998–1999 and 1999–2000. To redress this imbalance, expenditure growth in 2000–2001 (and in the remaining years of the Medium Range Forecast period to 2003–2004) is planned to grow at a rate below the forecast growth of GDP. A modest deficit of HK\$6.2 billion is thus anticipated in 2000–2001.

MONETARY POLICY

In line with the US rate hikes, the Hong Kong dollar savings deposit rate and the best lending rate of the major commercial banks were raised by a total of 100 basis points in the first half of 2000, to 4.75 percent and 9.5 percent, respectively. Hong Kong dollar inter-bank interest rates had been on an arising trend since the beginning of the year, with 3-month interbank interest rate reaching around 7 percent in mid-May. It then started to ease as signs of slowdown in the US economy alleviated concerns over a further tightening of monetary policy by the Federal Reserve. The relatively thin spread between Hong Kong dollar and US dollar interest rates at the longer end moved into negative territory in June and reached –30 bp at end-August.

Movements of monetary aggregates diverged during the second quarter of 2000. Narrow money supply, HK\$M₁, contracted by 3.1 percent during the second quarter of 2000, after a decline of 2.9 percent in the previous quarter. On the other hand, both HK\$M₂ and HK\$M₃ rose by 1.6 percent in the second quarter of 2000, compared with a decline of 1.0 percent in the first quarter. The increase in the broad money was mainly attributable to the rise in HK dollar time deposits during the period.

As the domestic economy continued to show signs of recovery, domestic credit began to bottom out in the first half of the year. Total outstanding domestic loans recorded a year-on-year decline of 2.5 percent at end-June 2000, representing a significant moderation over a 10 percent decline at end-June 1999. The overall quality of the loan portfolio of banks in Hong Kong, China continued to improve. For local banks the share of overdue and rescheduled loans in total loan portfolio reduced slightly from 7.0 percent at end-1999 to 6.9 percent at end-June 2000, while the share of classified loans ⁽¹⁾ decreased from 9.8

percent to 9.3 percent over the same period. The consolidated capital adequacy ratio of local banks rose to 18.9 percent, slightly higher than 18.7 percent at the end of 1999.

ECONOMIC OUTLOOK

Hong Kong, China's economy has clearly recovered from the severe setback brought about by the Asian Financial Crisis. The earlier overshoot in the property market has been rectified. The labour market has improved with the unemployment rate declining. The cost of doing business has come down visibly. Together with the process of corporate restructuring and downsizing seen last year, this has enabled the economy to restore competitiveness expeditiously. With the prevailing sanguine external environment, economic activity in Hong Kong, China, is expected to remain intensive. For 2000 as a whole, GDP is forecast to grow by 8.5 percent in real terms.

The prospects for the Hong Kong, China economy beyond the short-term remain bright, benefiting from the sustained robust growth in China as well as the further economic reform and liberalization in China upon its accession to the World Trade Organization. With the earlier concerns about Hong Kong, China's growth prospects in the wake of the Asian Financial Crisis now alleviated, the trend of GDP growth rate in real terms for the medium-term period is forecast at 4 percent per annum.

⁽¹⁾ Loans that are classified as substandard, doubtful or loss under the HKMA's loans classification system.

INDONESIA

REAL GROSS DOMESTIC PRODUCT

After falling by 13.01 percent in 1998, the economy showed signs of recovery beginning in the second quarter of 1999 when real GDP grew by 3.7 percent (year-on-year), followed by 1.18 percent in the third quarter. In the fourth quarter, real GDP grew by 5.01 percent, and for the year as a whole, GDP grew by 0.31 percent. The positive growth in 1999 was mainly attributable to private consumption while investment and export and import activities, despite their negative growth, showed an improving trend.

The economic turnaround from deep recession to modest growth has been produced largely by manufacturing, agriculture and public utilities. This growth reflected the consumption-led nature of the recovery. In contrast, the financial sector continued to be in recession, as reflected by its underlying structural and insolvency problems.

The quarterly GDP growth continues to be positive as shown by its 3.60 percent growth (year-on-year) in the first quarter of 2000. It then grew further to 4.13 percent (year-on-year) in the second quarter. The main source of growth again came from domestic demand and better export and investment performance. However, consumption growth in the second quarter was slower than in the previous quarter. The Bank Indonesia's consumer survey showed that the second quarter consumer confidence index was lower than that of the previous quarter.

Investment activities have shown a moderate improvement, especially since the fourth quarter of 1999. Private/business sector investment rose as domestic and foreign investment projects approved in the third quarter in 1999 began implementation in the second quarter of 2000. Manufacturing, construction and trade all recorded positive growth in the second quarter of 2000.

INFLATION

After recording a high annual inflation rate of 77.6 percent in 1998 associated with the country's financial crisis, price stability has now been restored. In 1999, inflation for the year as measured by the CPI, stood at only 2.01 percent. This lower inflation outcome for the year reflected the actual price decreases registered for several months.

Since April 2000, inflation has shown an upward trend in line with government policies to raise electric tariffs, the price of premix (special type of gasoline), transportation costs, telephone rates, and minimum wages. Quarterly inflation increased from 0.94 percent in the first quarter to 1.91 percent in the second quarter of 2000. During the first half of 2000, the inflation rate reached 2.86 percent compared to 2.73 percent during the same period in the previous year. Considering that the administered commodities are being used as inputs for the production of many other products, the inflationary pressure for the next quarter is projected to increase further. The depreciation of the rupiah since the beginning of 2000 will also put further pressure on the inflation rate.

BALANCE OF PAYMENTS

Indonesia's balance of payments (BOP) during 1999 recorded an overall surplus. This shows a current account surplus more than offsetting the deficit in the capital account. This outcome was similar to that of 1998 but contrasts to the current account deficits which Indonesia experienced in 1997 and earlier when the capital account was in a surplus position as a result of strong private capital inflows.

The observed slight increase in the current account surplus from US\$4.1 billion in 1998 to US\$5.8 billion in 1999 was due to higher exports and lower imports. The increase in exports was attributable to higher oil/gas exports, while non-oil/gas exports remained largely sluggish. In terms of its share of GDP, however, the current account surplus showed a slight decline from 4.3 percent in 1998 to 4.1 percent in 1999 due to the rupiah strengthening against the US dollar in 1999.

The current account surplus in the first half of 2000 increased to US\$3.9 billion, compared with US\$2.4 billion during the same period in the previous year. This was mainly attributable to higher oil prices as well as strong growth of non-oil/gas exports. Non-oil gas exports made a strong rebound, growing by 21 percent in the first half of 2000 against a negative 13.7 percent in the same period of the previous year.

In the second quarter of 2000, non-oil/gas exports continued to show an improvement, increasing by 7.3 percent compared to the previous quarter (5.1 percent). This increase was brought about by an increase in exports of manufactured goods, such as electronics, textiles, wood and paper products. On the import side, non-oil/gas showed an improvement though it still recorded a negative growth of 5.4 percent as compared to 7.9 percent in the previous quarter. The increased imports were due to the resumption of economic activities, with non-oil/gas imports still dominated by imports of raw materials, capital goods, and consumption goods. The overall performance of the external sector in the second quarter was characterized by a lower current account surplus of US\$1.3 billion as against US\$2.0 billion in the earlier quarter.

EXCHANGE RATE

Consistent macroeconomic policies, as exemplified by a tight monetary policy, have been instrumental in stabilizing the economy and reducing exchange rate volatility during 1999. This condition was strengthened with the improved international confidence in the new government following the peaceful conduct of the presidential and vice-presidential elections. For the whole year of 1999, the rupiah strengthened from around Rp 8,000 against the US dollar in December 1998 to Rp 7,000 per US dollar at the end of 1999.

However, entering the first quarter of 2000, negative market sentiment along with heightening political and economic uncertainties put strong pressure on the rupiah to depreciate. During the second quarter of 2000, the rupiah on average depreciated by around 11.6 percent, from Rp 7,391 in the first quarter to Rp 8,255 to the US dollar in the second quarter. It went on to

depreciate to as low as Rp 9,000 at the end of July 2000. The Ambon and Aceh crises, the banking sector's scandal, the annual session of the people's consultative assembly in August 2000 as well as the downgrading of Indonesia's credit rating from CCC+ to Selective Default (SD) have resulted in uncertainties in political and economic conditions.

FISCAL POLICY

For fiscal year (FY)1999/2000, the overall fiscal deficit stood at Rp 16.9 trillion, or 1.5 percent of GDP, much lower than the 6.8 percent budgeted at the start of the fiscal year. This lower fiscal deficit was due to a number of factors. First, on the revenue side, receipts were much stronger than anticipated. This was particularly due to higher government incomes from oil/gas activities. Second, on the expenditure side, government spending was much slower than budgeted. This was particularly attributable to a slowing down in investment and spending, owing to the delay in the international creditor's financing.

For FY 2000 (covering only the last nine months of calendar year 2000 in a transition to allow the fiscal and calendar years to coincide in the future), an overall deficit of 4.8 percent of GDP is predicted/the target. However, as of July 2000, the government's fiscal operation recorded a surplus amounting to Rp 17.0 trillion. This development, however, is seen not to give enough stimulus for re-energizing economic activities. On the revenue side, the main sources of the contraction were the income and value-added taxes, which accounted for as much as 50 percent of total revenue. On the expenditure side, the bulk of the spending was allocated to wages and interest payments of government bonds resulting from bank recapitalization.

MONETARY POLICY

In 1999, Bank Indonesia continued to implement prudent monetary policies aimed at recovering exchange rate stability. To attain these policy objectives, a number of intermediate indicative targets of monetary aggregates and variables have been formulated and publicly announced. These intermediate targets include base money (BM), net international reserves (NIR), and net domestic assets (NDA).

Reflecting the tightening of monetary policies in early 1998, the growth of the monetary aggregates, measured on a year-on-year basis, has been brought back under control and has dropped considerably. The base money target performance for the year has remained largely on track, with the exception of December 1999. After increasing sharply to Rp 101.8 trillion in that month, the base money position has declined gradually to Rp 88.9 trillion at the end of March 2000. This development indicates that the deviation of base money from the target by as much as Rp 16.7 trillion in the end of the year was just temporary.

The broader monetary aggregates (M_1 and M_2) behaved in similar fashion as base money, M_0 . In line with the shift in deposits to currency, the measured nominal and real M_1 also increased sharply. Until December 1999, M_2 was still increasing in nominal and real value. On the component side, there was a shifting trend of assets holding from deposits to currency. The

expected seasonal factors, such as Christmas, New Year, and Ramadhan, and the concern about Y2K issues also played a role in the increasing currency demand.

Inflationary pressure subsided and the rupiah strengthened, allowing a gradual reduction of the interest rate within the context of the overall monetary policy program. The benchmark SBI auction rates declined subsequently from around 38 percent at the end of 1998 to around 22 percent in mid-1999 and continued to decline to 12.51 percent by the end of December 1999. The lower SBI rate, in turn, has been followed by a further decline in deposit rates.

However, since the start of 2000, monetary aggregates as reflected by base money have tended to move above their indicative target due to the strong demand for currencies resulting from stronger than expected economic growth and the precautionary motive of the general public in anticipation of unexpected events.

Consequently, at the end of the second quarter of 2000, the SBI rate increased to 11.74 percent from 11.03 percent in the first quarter. On July 26, 2000, the 1-month SBI weighted average interest rate was 13.53 percent. An expansion in base money (driven by interest payment of government bonds, SBIs and rupiah intervention), the pressure on the rupiah as well as the hike in foreign interest rates have prompted the monetary authority to adopt a tight monetary policy stance through open market operations.

BANKING DEVELOPMENT

The cost to December 1999 of the banking restructuring process had reached Rp 540 trillion in the form of government bonds. In 2000, additional government bonds amounting to Rp 120.2 trillion would be issued.

Up to December 1999, loan-restructuring realization increased, especially in government banks. In the meantime, loan restructuring in private banks appeared to be on hold.

Non-performing loans of banks have declined due to the shifting of some loans to the Indonesian Bank Restructuring Agency (IBRA) and the positive results of loan restructuring since July 1999. Further restructuring would take effect after October.

MAIN STRUCTURAL REFORMS

Fiscal reform

The fiscal reform agenda has been implemented. Consistent with the approved budget, Parliament is expected to approve the amendment to the Value Added Tax (VAT) Law. Other tax reforms, such as the provision of tax privileges for the Integrated Economic Development Zones (KAPETs), rationalization of import tariffs on capital goods and the imposition of a flat 5 percent duty on exempted goods, have been implemented.

In line with fiscal reform, the government commits itself to delivering greater fiscal transparency, improving treasury management procedures, consolidating the number of bank accounts of government agencies, and ensuring consistency between monetary and fiscal data.

Preparations for implementing fiscal decentralization in 2001 will be guided by some key principles. The key principles are: (1) revenue transfer to sub-national governments shall be consistent with responsibilities, (2) expenditure responsibilities shall be developed in graduating fashion in keeping with the capacities of the sub-national governments, and (3) specific mechanisms shall be developed to ensure that any borrowing by sub-national governments shall be kept within strict limits. The recently established Regional Autonomy Advisory Council (RAAC) and the Coordinating Team are leading the process.

Banking System Reform

Regarding governance of the banking system, several improvements have been made including, among others:

1. The IBRA has concluded its evaluation of all outstanding interbank claims under the guarantee scheme. Settlements have now been taking place in all cases, except for very small claims under litigation. The IBRA and Bank Indonesia are implementing plans to ensure that banks whose claims were ineligible remain adequately capitalized.
2. A new governance and oversight framework for the IBRA is being developed with the assistance of an international consulting firm, and in collaboration with the World Bank. This new governance framework for the IBRA, including an independent governing body, was established at the end of June 2000.
3. In improving its transparency, the IBRA has commenced regular publication of its activities, by way of monthly reports on: sales and collection activities, progress in loan restructuring and disposal of industrial assets; and quarterly financial reports by the BTO banks. In June 2000, the IBRA published the audit report of its end-1999 accounts, with the assistance of an international accountancy firm. The IBRA also issued its first comprehensive annual report during the third quarter.
4. To coordinate the government's response to uncooperative debtors and former bank shareholders, a new body—the Committee for Resolving the Cases of Recalcitrant Debtors—was established at the end of May.

With regard to state and BTO bank restructuring, the Ministry of Finance has established a governance and oversight unit for state-owned and recapitalized banks. This unit is responsible for overseeing the stakeholders' interest in the banks and ensuring compliance with their business plans.

Regarding the supervisory and regulatory framework, Bank Indonesia is implementing a comprehensive master plan to upgrade bank supervision and comply with international regulatory norms by end-2001, assisted by international experts. The master plan will focus on improving the quality and timeliness of offsite reporting the data of all banks, and on making operational a program of special surveillance for systemically important and problem banks. Bank Indonesia will also upgrade its regulatory framework. On March 30, Bank

Indonesia issued a decree concerning the setting out of the conditions under which it will transfer banks to the IBRA.

Furthermore, to strengthen the regulatory and the governance structure of the pension and insurance industries, finance companies, and the capital markets, reform on the nonbank financial institution is on the agenda. These reforms are being designed with assistance from the Asian Development Bank (ADB).

With regard to the Bank Indonesia audit, said bank has been implementing in a timely way measures aimed at addressing the issues raised by the Supreme Audit Board (BPK) report to Parliament on December 31, 1999 and clarifying Bank Indonesia's financial position, as outlined in the January MEFP. At end-June 2000, Bank Indonesia published an audited statement of its financial accounts for end-1999. Over the coming months, in consultation with the BPK, it will take steps to address remaining audit issues, including the full divestment of financial subsidiaries, as well as the aggressive strengthening of management information systems, financial and operational controls, and accounting policies to reflect best practices. A due diligence of all Bank Indonesia's subsidiaries will be completed by June 2000 ahead of their planned disposition, which was to be substantially completed by end-2000.

With regard to bond market reform, Indonesia has begun the development of a domestic bond market by making an initial share (10 percent) of the bonds issued for bank recapitalization eligible for trading. A debt management office (DMO) will coordinate future bond issues and the development of a debt management strategy in consultation with Bank Indonesia. The government will also submit to the Parliament a draft law on debt management that will ensure automatic appropriations of debt-service payments for all government bonds issued.

MEDIUM TERM OUTLOOK

In 1999, the key macroeconomic indicators of the Indonesian economy provided evidence suggesting that the process of Indonesian economic recovery was gaining greater momentum in line with improvements in various sectors. This is in line with gains on both the domestic political and economic fronts. Inflation has subsided, interest rates have declined, and the rupiah has stabilized.

Toward mid-2000, the economic recovery was well underway. However, a number of strains appear to stand in the way of economic recovery. The rupiah has been continually under pressure, with eventual adverse consequences on inflation. In addition, the bank intermediation function has yet to fully recover as the banking recapitalization process and corporate restructuring are not optimally implemented. The increasing domestic uncertainty, which was reflected in an increase in risk premium and a weakening of the exchange rate, has subsequently resulted in greater inflation pressure and a higher interest rate. These in turn might halt banking and corporate restructuring as well as the recapitalization process, particularly debt restructuring. However, with the peaceful completion of the annual session of the People's Consultative Assembly and the formation of a new economic team in the cabinet, the trend of economic recovery should turn for the better.

Economic activity for the whole of 2000 should expand more strongly than in 1999, although it remains lower than its historical norm before the crisis. The GDP growth for the year 2000 is projected to surpass the original projection range of 3 to 4 percent. On the demand side, the source of aggregate demand expansion and economic growth is expected to originate from private consumption, investment, as well as exports. Consumption should be moderating while investment and exports should be picking up. Given its share of GDP (the largest at 77 percent), consumption is seen to remain important in driving the recovery. Such an improving outlook is supported by the business survey, which indicated that more respondents expect to see their activities picking up in the next quarter. In parallel, the consumer survey also suggested a more optimistic trend in the next quarter.

At the start of the year, the inflation rate for 2000 is targeted to range between 3 and 5 percent (taking no account of a prices and incomes policy) or 5 and 7 percent (including such a policy). In view of the persistently weakening exchange rate during most of the year, it looks increasingly likely that the inflation outcome will exceed the target. To keep the inflation rate within a reasonable level and to keep the exchange rate movement less volatile, monetary policy is continuously being directed to absorbing excess liquidity in the money market, which at the same time will reduce the use of the rupiah for speculative activities. The tight monetary policy and strategy understandably will push interest rates higher but gradually they will be reduced/eased down in line with the prevailing money market conditions.

JAPAN

GROSS DOMESTIC PRODUCT

The Japanese economy is now on track for modest recovery. In fiscal year (FY) 1999 (April 1999-March 2000), real gross domestic product (GDP) grew by 0.5 percent, following two consecutive years of contraction of the economy (−0.1 percent in FY1997 and −1.9 percent in FY1998). (On a calendar year (CY) basis, real GDP increased by 0.2 percent in 1999 from a −2.5 percent in 1998). Real GDP grew by 1.0 per cent in the second quarter of 2000 compared to the previous quarter.

Two factors contributed to this modest economic recovery: stimulative macroeconomic policies in 1998 and 1999, and the rebound in Asian economies. Public investment recorded a positive growth for three consecutive quarters (compared to the previous quarter) beginning the fourth quarter of 1998, which underpinned the recovery, but posted a negative growth since the third quarter of 1999. Overall, real public investments decreased by 0.9 percent in FY1999. Exports have also been increasing, especially those to Asia, as the Asian economy has recovered rapidly from recent Asian Financial Crisis. In FY1999, total real exports of goods and services increased by 6 percent. (Growth for exports of goods and services based on CY 1999 is 1.9 percent).

Due to these factors, positive signs for economic recovery have begun to be observed in some fields of economic activities, especially in business activities.

Although real private non-residential investment decreased by 2.3 percent in FY1999, the decline seems to have bottomed out. The number of firms that take positive action such as increasing the amount of fixed investment is increasing gradually, especially in high-growth sectors.

Regarding consumers' activities, private consumption remained weak because of falling real earnings and uncertainty about employment prospects as it recorded negative growth in the third and fourth quarters of 1999. It then recovered in the first quarter of 2000 and recorded a 1.2 percent increase (in real terms) for the entire FY1999.

INFLATION

Reflecting the sluggishness of private consumption, previous yen appreciation, large decline in fresh food prices and effects of deregulation, the rate of increase in the consumer price index (CPI) has been very stable. CPI dropped by 0.5 percent in FY1999 (−0.3 percent on CY 1999) and is expected to rise by around 0.3 percent in FY2000. Domestic wholesale prices hit the bottom of the downward trend in FY 1999 but has remained almost at the same level since then due to price increases in the international commodity market, including for crude oil and to progress in inventory adjustment. Domestic wholesale price index (WPI) dropped by 1.0 percent in FY1999 and is expected to drop by around 0.1 percent in FY2000.

EMPLOYMENT

The prolonged economic slump had serious impacts on the labor market, raising the level of unemployment and putting downward pressure on wages. Unemployment rate has remained high throughout FY1999 and recorded a historical high at 4.9 percent in February and March 2000. The number of the employed decreased by 0.5 percent and the unemployment rate rose to 4.7 percent in annual average in FY1999.

Although conditions in the job market indicate that labor adjustment pressures remain strong, the unemployment rate in FY2000 is expected to decline slightly to the level of 4.5 percent as a result of economic recovery. Thereupon, the number of the employed is expected to increase by 0.4 percent.

BALANCE OF PAYMENTS

Exports and imports, especially those to and from Asia, are increasing. In FY1999, real exports of goods and services increased by 6.0 percent and real imports increased by 8.8 percent. Current account surplus decreased from 15.2 trillion yen (3.1 per cent of GDP) in FY1998 to 12.6 trillion yen (2.6 percent of GDP) in FY1999.

In FY2000, real exports are expected to increase by 3.8 percent while real imports are expected to increase by 3.7 percent. The current account surplus is expected to decline slightly to 11.4 trillion yen (2.3 percent of GDP) in view of the faster increase in import values than export values as a result of higher oil prices.

Capital account deficit decreased significantly from 16.8 trillion yen in FY1998 to 4.3 trillion yen in FY1999.

Foreign direct investment (FDI) outflows from Japan increased by 42.6 per cent from 5.2 trillion yen in FY1998 to 7.4 trillion yen in FY1999 while the FDI inflows to Japan went up significantly from 1.3 trillion yen in FY1998 to 2.4 trillion yen in FY 1999 for a 74.5 percent increase, reflecting a rapid growth of M&As (mergers and acquisitions).

TOTAL EXTERNAL ASSETS

Following the historical high of 133 trillion yen in calendar year (CY) 1998, net external assets decreased to 85 trillion yen in CY1999. Gross external assets amounted to 308 trillion yen while gross external debt registered at 223 trillion yen in CY1999.

EXCHANGE RATE

The Japanese yen has appreciated substantially from 124yen/US dollar in May to 102yen/US dollar in December 1999, representing around 17.8 percentage point appreciation. The rapid rise of the yen is regarded as a major concern for the recovery of the Japanese economy in the short-run as it leads to decreases in the profits of export-oriented firms.

Experiencing a temporary depreciation at the beginning of 2000, the yen came close to 111yen/US dollar in February 2000. After that, the yen appreciated once ore and has since been moving in the range of 103 to 110 yen/US dollar.

FISCAL POLICY

Fiscal policy has played a major role in supporting economic activities. The government launched the Policy Measures for Economic Rebirth in November 1999, aiming to achieve a smooth transition from public sector-led growth to private sector-led growth and to put the Japanese economy back on the path of full-fledged recovery. The total amount of the measure in project volume was about 17 trillion yen (or 18 trillion yen in total, including nursing care measures), including measures for the financing of small- and medium-sized enterprises (7.4 trillion yen) and spending on social infrastructure projects (6.8 trillion yen).

The FY2000 budget has been prepared with the objective of fully supporting the government in putting the economy back into the track of full-scale recovery. In addition, the government decided in September 2000 to compile a supplemental budget of 3.5 to 4 trillion yen to strengthen the move of the Japanese economy onto an autonomous recovery path.

On the other hand, the ratio of government bond issues to total government expenditures in the FY2000 budget is expected to reach 38.4 percent and outstanding government bonds are expected to reach around 364 trillion yen (73 percent of GDP) at the end of FY2000. Under these circumstances, the fiscal structure should be reformed. It will be necessary to promptly review various fiscal and taxation issues and carry out comprehensive measures once the economic recovery is firmly established.

MONETARY POLICY

Facing the severe economic situation, the Bank of Japan (BOJ) followed the “zero interest rate” policy since early 1999. Short-term interest rates were virtually zero since early March 1999, except for a period in which money demand rose because of the Y2K issues. The BOJ terminated the zero interest policy in August 2000, and short-term interest rates have made a slight increase after that.

Long-term interest rates declined to 1.2 percent until mid-May in 1999 following BOJ’s zero interest rate policy and the Ministry of Finance’s announcement to change the composition of maturity periods of government bonds. Afterwards, they started to pick up and rose up to nearly 2.0 percent in end-August in 1999 and have been moving within a narrow range of 1.5 percent to 1.9 percent since then. Long-term interest rates rose in August 2000 after the termination of the zero interest policy.

Although the stringent corporate climate finance has been relieved not only for large firms but also for medium-sized firms, lending by financial institutions remains stagnant.

MEDIUM-TERM OUTLOOK

The main thrust of the economic and fiscal policy of the Japanese government should continue to be to sustain economic recovery. In making every effort to bring the economy to an autonomous recovery path, the government is to carefully monitor economic conjunctures and take appropriate actions. Priority should also be placed on the bold reform of the economic structure. From this perspective, the government is compiling a set

of new economic policy measures that should be rapidly implemented with the four pillars: the IT revolution, environmental countermeasures, response to the aging society, and urban redevelopment.

The growth rate of real GDP in FY2000 is expected to be around 1.0 percent. This will be achieved by the strong increase in private non-residential investment reflecting the improvements in corporate confidence and the recovery of profits as well as moderate increase in private consumption.

The Cabinet decided to adopt the economic plan in July 1999, outlining the long-term perspective of the Japanese economy and society up to 2010. In the annex to the economic plan, the prospects of the main economic indicators up to 2010 are given as follows:

Real growth rate: approximately 2 percent (in terms of “growth accounting”)

Inflation rate: approximately 2 percent

Unemployment rate: the latter half of 3 percent to the first half of 4 percent

REPUBLIC OF KOREA

REAL GROSS DOMESTIC PRODUCT

Real GDP grew by 13 percent year-on-year in the fourth quarter of 1999, bringing the growth rate for the whole year to 10.7 percent. This was the highest real GDP growth rate since 1987. Looking at the GDP growth in terms of economic activity, agriculture, forestry, and fishing production increased by 2.7 percent year-on-year in the fourth quarter of 1999. GDP growth in terms of expenditure had private consumption registering a 10.3 percent increase due to higher household spending, especially on durable goods, such as cars, mobile phones, personal computers, and furniture.

During the second quarter of 2000, GDP growth was slightly down, at 9.6 percent compared with the previous quarter. However, it is projected that real GDP will grow by 8.5 percent with a trade surplus of 10 billion won this year. Recovery in domestic consumption and booming exports along with inventory build-up are behind the optimistic projection for GDP growth.

INFLATION

In September, consumer prices rose by 1.5 percent, and producer prices also rose, by 0.6 percent. The prices of agriculture, livestock, and marine products showed high increases in September due to typhoons. Petroleum, chemical and plastic products led the increase in industrial product prices due to the rise in international crude oil prices. Housing prices in February continued to rise following the trend of the previous month, reflecting seasonal factors.

Core inflation, which is calculated by removing the prices of petroleum fractions and agricultural products except cereals from the consumer price index (CPI), rose by 0.7 percent in September, which was the highest increase since the 1.0 percent recorded in March 1998.

High oil prices, combined with the speedy economic recovery and wage hike demands by unions will further add to the inflationary pressure. The central bank plans to keep inflation within the 1.5 percent to 3.5 percent range in 2000.

EMPLOYMENT

In August 2000, the population over the age of 15 increased by 1.0 percent (or 374,000 persons) to 36,195,000 persons, and the economically active population increased by 1.4 percent (or 304,000 persons) to 22,071,000 persons compared to the same month last year. The number of jobless fell to 0.82 million from 1.24 million a year earlier. The unemployment rate fell to 3.7 percent, slightly higher than the previous month's level.

The unemployment rate is expected to moderate in the coming months, as the demand for consumer goods and a pick-up in construction activity continue in line with the sustained economic recovery. However, the structure of new employment is different from that of the previous period, with more and more people working as temporary employees, and being employed for fewer hours.

TRADE BALANCE

Imports, on a customs clearance basis, did not change during September from the previous month's level of US\$13.4 billion. Meanwhile, exports by Korean companies amounted to US\$15 billion. As a result, the trade surplus was US\$1.6 billion, which is slightly larger than the US\$1.5 billion of the previous month.

In terms of commodity groups in July, the high growth rates continued for exports of information and communication equipment (102.7 percent), passenger cars (5.3 percent), and chemicals and chemical products (24.6 percent). By export destination during July, exports to both industrialized economies (29.3 percent) and developing economies (17.3 percent) increased notably. Meanwhile, imports of raw materials increased by more than 42.2 percent, as a result of higher oil prices. The increasing demand for telecommunications and electronics products, including personal computers, has also added to the import bill by necessitating the increased importation of foreign-made parts and components. Over the course of the next few months, it is anticipated that the increase in imports will slow down as a result of stabilizing oil prices.

TOTAL EXTERNAL LIABILITIES

As of the end of July, Korea's total external liabilities amounted to US\$142.1 billion, up by US\$1.1 billion from the previous month. This increase was attributed to a greater number of trade credits being linked to economic recovery and the increased borrowing of domestic branches of foreign banks from their headquarters. The share of short-term external liabilities to total external liabilities was 33.6 percent.

Korea's total external credit in July increased by US\$1.2 billion to US\$162.8 billion while total net credit increased by US\$0.1 billion from the previous month to US\$20.7 billion.

EXCHANGE RATE

The won gained approximately 3.3 percent in value, year-on-year, against the US dollar in August. The won broke through the 1,200 won/US\$ level in November last year and this upward trend continued through the first quarter of 2000. The dollar traded at 1,131 won in January, 1,128 won in February and 1,117 won in March; and averaged at 1,109 won per dollar in January to August 2000. The rise in the won has been caused by the huge inflow of foreign investment funds, which amounted to US\$3.5 billion during the first two months of 2000, equal to 65 percent of last year's total net inflow.

FISCAL POLICY

The budget deficit in year 2000 is expected to amount to some 2.0 percent of GDP. To achieve a balanced budget by the year 2003, however, the government will have to operate on the basis of a tight fiscal policy, and the national budget for next year will be raised by just 0.6 trillion won from that of this year to a total of 10 trillion won (US\$8.8 billion). This would bring the budget growth rate down to 6 percent, or 1 to 2 percentage points lower than expected. As less income from the sell-off of state-run enterprises is expected, the government will seek to improve the efficiency of fiscal expenditures by rearranging its public investment priorities. At the same time, the government will secure stable

revenue sources by implementing tax measures on illegal and under-reported incomes, and by reducing tax exemptions where the government deems it necessary.

MONETARY POLICY

The central bank will implement a flexible monetary policy to keep the core inflation rate within the 1.5 percent to 3.5 percent range this year; interest rates will remain in single digit territory. For the first quarter of this year, consumer prices and core inflation rose by 1.5 percent and 0.8 percent, respectively, which was well within the targeted range. In the financial markets, while overall liquidity has increased significantly, the concentration of funds at the short-term end of the market has persisted. Despite ample liquidity, however, the recent uncertainties related to the ailing investment trust companies (ITCs) remain as latent factors serving to destabilize the financial markets. Therefore, it is essential to establish a clear-cut plan for the restructuring of the troubled ITCs as soon as possible. Reflecting the financial sector circumstances, the Monetary Policy Committee of the Bank of Korea has decided that the overnight call rate would be maintained near its current level (5 percent) in May.

MEDIUM-TERM OUTLOOK

After the onset of the financial crisis, Korea suffered a serious economic downturn. However, the Korean government, on the basis of the IMF program, implemented drastic reforms to correct the structural weaknesses inherent in its economy. The economic restructuring was carried out in the corporate, financial and labor sectors in order to promote transparency, efficiency and flexibility.

Starting 1999, the Korean economy has shown a trend of rapid recovery. The growth rate, after falling by -5.8 percent in 1998, was up 10.7 percent in 1999 and 9.6 percent in the second quarter of this year. The high growth in the second quarter can be best explained by robust growth of domestic demand and exports. Corporate investments shot up by 41.3 percent year-on-year during this period compared with a 38 percent gain in 1999, due to active investment in machinery, ships, railways, car and automobiles. Exports of goods and services surged 22.9 percent year-on-year on strong overseas demand for computers, semiconductors and communications equipment. Imports of goods and services increased by just 19.8 percent, lower than the 28.3 percent rise recorded in the previous year. Private consumption rose, by 9.0 percent year-on-year compared with a 10.3 percent gain for the same period in the previous year, and government expenditures edged up 0.5 percent year-on-year versus a 1.7 percent fall the year before.

The real GDP growth in 2000 is likely to be as high as 8.5 percent, considering the rapid growth of domestic demand, such as private consumption and equipment investment. Private consumption is expected to experience a 7.6 percent growth in 2000 in tandem with an increase in real income and an expected decline in unemployment. Equipment investment, as a percentage of GDP, will rise to the pre-crisis level as the ongoing and strong investment expansion will continue through 2000, while construction investment is expected to revert to a positive growth trend in the second half of 2000 given the conventional time lag between construction orders and actual investment. The current account surplus is likely to shrink to approximately US\$10 billion in 2000, down from US\$25 billion in 1999, in line with the sharp rise in import demand resulting from the rapid expansion of domestic demand. The contributions to price stability of the

deflationary GDP-gap, currency appreciation, and relatively stable wage growth are likely to decline in the future.

MALAYSIA

REAL GROSS DOMESTIC PRODUCT

Gross domestic product (GDP) growth in 1999 was stronger than forecast, while all other developments in the Malaysian economy were in line with expectations.

The selective exchange controls implemented in September 1998 allowed Malaysia to emerge from the recession with strengthened macroeconomic fundamentals. In 1999, GDP recorded a strong positive growth of 5.8 percent, from a contraction of 7.4 percent in 1998. The value of GDP has returned to almost the same level as in 1997. Following the increase in nominal gross national income of 3.8 percent, per capita gross national product (GNP) turned around to register a positive growth of 1.4 percent to RM 12,305 (US\$3,238) in 1999 from RM 12,135 (US\$3,093) in 1998. In 1997 per capita GNP was RM 12,310 or US\$4,376.

The policy measures implemented by the government have been successful in addressing immediate-term issues without undermining medium-term growth potential. On the supply side, growth was initially driven by the strong performance of the export-oriented industries in the manufacturing sector. The recovery became increasingly more broad-based during the course of the year. Within the manufacturing sector, growth became broad-based from the second quarter onwards as both domestic and export-oriented industries registered positive growth rates.

In 1999, value-added in the manufacturing sector increased by 13.5 percent from a negative 13.7 percent in 1998, following expansion in output of the manufacturing sector since February 1999. With the overall improvement in the economy, the services sector turned around to increase by 3.3 percent in 1999.

On the demand side, strong economic growth was sustained by robust export performance, accelerated public sector expenditure and a revival in private consumption expenditure. Growth in real aggregate domestic demand (excluding stocks) increased by 1.7 percent in 1999, due mainly to the fiscal stimulus measures implemented by the government and the revival in private/business sector consumption expenditure.

INFLATION

The relative stability of the ringgit exchange rate, excess capacity in the economy and lower commodity prices led to more moderate price increases in 1999. Inflation as measured by the consumer price index (CPI, 1994=100) rose at an annual rate of 2.8 percent in 1999, lower than the earlier estimate of 3 percent.

TRADE ACCOUNT

The overall balance of payments position strengthened further to record a surplus of RM 17.8 billion or US\$4.7 billion, driven by favourable external trade balance and a large net inflow of long-term capital. In the trade account, gross exports (in US dollar terms) have increased for five consecutive quarters, while import growth has turned positive since the second quarter of 1999. In US dollar terms, exports of manufactured goods rose by 18.2

percent, benefiting especially from strong global demand for electronic products such as semi-conductors, personal computers and other information and communications-related components. Following the rebound in exports, imports of intermediate goods in US dollar terms have recorded positive growth since March 1999. Nevertheless, export growth was stronger (13.2 percent) relative to import growth (9.4 percent), contributing to a record merchandise surplus of RM 86.5 billion (US\$22.8 billion) and a large current account surplus of RM 47.9 billion (US\$12.6 billion) or 17.1 percent of GNP in 1999.

The overall balance of payments recorded a surplus of RM17.8 billion, after adjusting for revaluation losses from ringgit appreciation, increased short-term trade credits, further reduction in short-term external debt of commercial banks and the non-bank private/business sector and some liquidation and repatriation of portfolio investment by foreign investors. Consequently, the net international reserves increased to RM 117.2 billion (US\$30.9 billion) as at end-1999, from RM 99.4 billion (US\$26.2 billion) at the end of 1998. This level of reserves was sufficient to finance 5.9 months of retained imports (5.7 months in 1998). In addition, the international reserves were 5.1 times the short-term external debt.

EXTERNAL DEBT

Malaysia's policy of active debt management, guided by prudential safeguards and an efficient debt monitoring system, has enabled the country to keep the overall external debt situation manageable. The nation's total external debt outstanding declined marginally by 0.4 percent to RM 160.5 billion at the end of 1999, reflecting reductions in the short-term debt as well as longer-term private sector external debt. The total debt was equivalent to US\$42.3 billion compared to US\$42.4 billion in 1998. The improvement in the debt situation in 1999 was reflected in the decline in the ratio of external debt to GNP and to exports to 57 percent and 43 percent, respectively. The Federal Government's external debt, although higher in 1999, accounted for only 11.4 percent of total external debt, while the non-financial public enterprises accounted for 36.5 percent. The balance was private/business sector debt, with the non-resident controlled companies in Malaysia accounting for a larger share of this debt (54%).

EXCHANGE RATE

In 1999, the ringgit remained pegged to the US dollar at the rate of RM 3.80. This pegged exchange rate has been effective since 2 September 1998. Under this arrangement, the ringgit exchange rate *vis-à-vis* other currencies is determined through cross-rates based on the movements of the US dollar against those currencies in the international foreign exchange markets.

The ringgit was relatively stable against most major currencies in 1999. The volatility of the ringgit against major currencies, with the exception of the Japanese yen, was reduced significantly.

Overall, the pegged exchange rate regime has benefited the economy by offering a period of relative stability, which has aided the recovery of economic activity and allowed the acceleration of financial reforms. It has helped manufacturers conduct their pricing and investment decisions in an environment of greater certainty. The peg has been sustainable

as it is consistent with the underlying fundamentals of the economy. At the same time, consistent macroeconomic policies have further ensured the viability of the regime.

MONETARY POLICY

The basic thrust of monetary policy in 1999, was to create an environment to support economic recovery and facilitate structural reforms, while preserving price stability. The easing of monetary policy which began in August 1998 was continued into the year. Against an environment of a strengthening financial sector; benign inflationary environment; improving balance of payments position and a more favourable performance of the world economy including the regional economies, monetary policy remained accommodative throughout the year. With the large trade inflows, however, an important task of monetary policy in 1999 was to manage excess liquidity to avoid inflationary pressures. While interest rates were reduced to support economic recovery, efforts were taken to ensure a positive real return to depositors.

The conduct of monetary policy was balanced to ensure that monetary easing did not destabilise the financial system and will continue to promote long-term savings. The year saw the imposition of more stringent guidelines aimed at strengthening the banks. These included, among others, guidelines governing the extension of lending to their controlling shareholders and guidelines on future capitalisation of banking institutions by controlling shareholders.

FISCAL OPERATIONS AND POLICY

The 1999 Budget announced in October 1998 focused on the counter-cyclical role of fiscal policy to revitalise economic activities and strengthen the nation's resilience and competitiveness. Various measures were also introduced to further improve the balance of payments; strengthen the financial sector; promote the services and agriculture sectors; and improve governance in the public and private/business sectors as well as ensure social well-being. Overall, the budget strategy reinforced the fiscal stimulus adopted in 1998 in line with the plan to revitalise the economy as set out in the National Economic Recovery Plan. The fiscal stimulus in 1999 as reflected by a budget deficit of 3.4 percent of GNP contributed to the restoration of consumer and investor confidence, particularly in the second half of 1999.

While the government undertook a stimulative role, fiscal prudence and discipline continue to be maintained to contain the fiscal deficit at a manageable level so as not to jeopardise long-term growth. The level of expenditure, therefore, was managed with the consideration that current revenue should be sufficient to finance operating expenditure; fiscal deficit be contained at a sustainable level, and availability of domestic and external financing without crowding out the private/business sector.

Meanwhile, the better-than-expected revenue out-turn in 1999, reflecting the strong pick-up in the momentum of economic recovery as the year progressed, provided the government with increased flexibility in managing its fiscal policy. It enabled the government to expand its fiscal stimulus to reinvigorate the economy further through increased expenditure during the course of 1999, without further deteriorating the budgetary position of the government.

MEDIUM -TERM OUTLOOK

Growth in the Malaysian economy is expected to be sustained in year 2000, while the external sector will continue to strengthen. Against the more favourable external environment and strengthening domestic economy, the forecast for GDP growth for 2000 has been revised upwards to 5.8 percent, from the earlier estimate of 5 percent. Given the strong recovery in the regional economies and the generally favourable world economic outlook for 2000, export growth is expected to be sustained at high levels. The external sector is expected to remain strong although the current account will narrow in line with higher output growth.

Private/business sector investment is expected to recover in line with improving investment sentiments and policy measures aimed at projecting the private/business sector to lead as the engine of growth. Measures to promote consumption under the 2000 Budget together with strong export performance will increase the disposable income of Malaysians, thereby strengthening consumer sentiments and expenditure. As stronger recovery in private/business sector expenditure took place, while public expenditures continued to support growth, real aggregate domestic demand is expected to strengthen further in 2000.

On the supply side, growth is expected to be more broad-based, led by the manufacturing and services sectors. The construction, agriculture and mining sectors are also expected to contribute to growth, although at relatively moderate rates. Prospects for the manufacturing sector remain favourable in 2000. Expected sustained external and domestic demand will support further expansion of value-added by 10 percent.

With the improved outlook for the economy, value-added in the services sector is expected to increase by 5.4 percent. Growth will emanate from the intermediate and final services sub-sectors. In particular, demand for transport, storage and communications services is expected to pick up strongly, reflecting mainly a strong increase in external trade. Activity in the finance sub-sector is also expected to increase, reflecting the projected higher loan growth and the favourable outlook in the equity market. Meanwhile, the return of consumer confidence and the expected increase in tourist arrivals from 8 million in 1999 to 8.5 million in 2000, are expected to contribute to higher growth in the wholesale, retail trade, restaurants and hotels sub-sector.

MEXICO

The Mexican economy continued to perform well in 1999. Economic activity rebounded from a slowdown that occurred in the last quarter of 1998 that reflected uncertainty in international capital markets and low world oil prices. The implementation of sound fiscal and monetary policies during 1999 enabled Mexico to achieve, and in most cases, surpass, the main economic targets established at the beginning of the year.

GROSS DOMESTIC PRODUCT

During 1999, an important recovery of domestic markets and the dynamism of external demand supported growth. The gross domestic product increased by 5.2 percent in the fourth quarter of 1999, and 3.7 percent for the whole year, higher than the original target of 3 percent. Thus GDP in current prices in 1999 reached 4,628,800 million pesos (approximately US\$490.99 billion).

The increase in GDP is largely explained by an expansion of total gross fixed capital formation, which grew 5.8 percent in real terms in 1999, mainly driven by private investment, which grew 9.3 percent. This increase was mainly brought about by a 7.1 percent expansion in machinery and equipment spending, and a 4.5 percent increase in construction investment. Total consumption, in turn, expanded 3.9 percent in real terms, reflecting the 4.3 percent growth in private consumption and the more moderate 1.0 percent increase in public spending.

The most dynamic component of the aggregate demand, however, was the export sector, which has become one of the main sources of growth for the Mexican economy. Merchandise exports increased 16.4 percent with their value reaching US\$136.7 billion in 1999.

In terms of sectoral performance, the primary sector (agriculture, livestock, fishing and forestry) expanded at a real rate of 3.5 percent in 1999. The industrial sector (mining, manufacturing, construction and electricity) and the services sector (which includes commerce, transportation, communications and financial services) grew 3.8 percent and 3.7 percent in real terms, respectively.

INFLATION

The Accumulated Consumer Price Index grew 12.32 percent in 1999, more than 50 percentage points lower than the official estimate of 13 percent. This was the result of the restrictive monetary policy implemented by *Banco de México* (Mexican Central Bank), the stability in international financial markets, and the commitment to sound public finances.

EMPLOYMENT

The current economic expansion has had a strong impact in the level of employment. This has resulted in historically low unemployment rates. The number of workers who joined the Mexican Institute of Social Security (IMSS) in 1999 was 706,041, of which 488,071 were permanent members. The total amount of workers covered by the IMSS increased 3.5 percent in 1999, reaching 10, 628,901 workers.

The favorable evolution of the economy drove the open unemployment rate to its historic low of 2.5 percent in 1999, the lowest figure since this indicator was first used in 1985. Furthermore, average real wages increased in 1999, with the largest increases being observed in the manufacturing sector.

EXTERNAL SECTOR

Despite the dynamism of economic activity, recent economic growth rates have not caused external imbalances that may undermine the confidence achieved in the later years. In this sense, in 1999 the current account deficit amounted to US\$14.0 billion, equal to 2.9 percent of GDP, lower than the US\$15.7 billion (3.2 percent of GDP) registered in 1998.

In 1999, the current account deficit was mainly financed with long-term foreign investment, mainly foreign direct investment (FDI), which reached US\$11.6 billion and accounted for 82.6 percent of such deficit. Portfolio investment in 1999, in turn, was US\$10.8 billion. The capital account registered a surplus of US\$14.1 billion in 1999, 19 percent less than the surplus registered in 1998.

Strong domestic demand in 1999 spurred imports, which grew 13.3 percent to reach US\$142.1 billion. Import growth, however, was smaller to the 14.1 percent increase in 1998. Imports of consumer goods in 1999 grew by 9.6 percent, while imports of capital and intermediate goods increased by 18.5 percent and 12.8 percent, respectively.

In 1999, the trade balance registered a deficit of US\$5.4 billion, 32.3 percent smaller than the deficit registered in 1998. As a percentage of GDP, the trade deficit for 1999 is equal to 1.1 percent. Total merchandise trade for 1999 was US\$278.8 billion, or 57.3 percent of GDP.

EXTERNAL DEBT

By end of 1999, net public sector external debt totaled US\$83.4 billion, equal to 15.8 percent of GDP. The public sector's external debt market amortization for the years 2000 and 2001 are moderate at US\$2.1 and US\$1.6 billion, respectively. For the last three quarters of 2000, total debt payments (market and non-market) amounted to US\$7,769.2 million.

In addition to the improved position of Mexico's external accounts, the ratio of the stock of total net public debt (internal and external) to GDP has fallen significantly. Year-end total net public debt as a proportion of GDP has fallen consistently from 67.4 percent in 1988 to 37.6 percent in 1994, to 24.8 percent in 1999.

EXCHANGE RATE

The flexible exchange rate regime adopted in Mexico in 1995 has become a significant factor of stability, given the current context of the country's economy. The floating exchange rate regime has allowed for gradual adjustments to external shocks instead of infrequent but large adjustments, while modifying the composition of capital flows towards longer tenors, and reducing the possibility of speculative attacks. The current arrangement has also prevented large and substantial misalignments of the real exchange rate, maintaining the competitiveness of the tradable sector.

In 1999, the Mexican peso showed remarkable stability *vis-a-vis* the US dollar. On 31 December 1998 the interbank selling rate closed at 9.9010 pesos per US dollar. A year later, on 31 December 1999, the same rate was 9.4900 pesos per US dollar, which compares favorably with the 10.1666 rate observed in 31 January 1999. On 31 March 2000, the interbank selling rate closed at 9.2610 pesos per dollar.

MONETARY POLICY

The monetary program for 1999 was geared towards reducing inflation through the avoidance of excess money supply, as well as providing the necessary flexibility in the monetary policy. In December 1999, M_1 increased 12.4 percent, while M_4 grew by 6.7 percent.

On January 13, 1999, Banco de México (BM) increased the “short” (or *corto*, the mechanism BM uses to reduce market liquidity) from 130 to 160 million pesos in order to limit the currency’s depreciation and stabilize the foreign exchange market. A year later, the BM decided to increase the *corto* again by 20 million pesos and thus reinforce the downward trend observed in the CPI and achieve the official inflation goal of 13 percent. On 16 May 2000, BM increased the *corto* to 200 million pesos, signaling its strong commitment to the reduction of inflation.

The ongoing reduction of inflation forecasts observed during 1999 and the lower country risk explain the significant reduction of nominal interest rates in 1999. This reduction, however, does not imply an easing of monetary policy, as this would immediately be followed by an exchange rate depreciation.

In this sense, the average nominal interest rate (28-day Cetes) in 1999 was of 21.8 percent, lower than the 24.8 percent observed in 1998. Finally, as of 31 December 1999 international reserves stood at 30.7 billion.

FISCAL POLICY

Throughout 1999, the Mexican government implemented several measures geared towards strengthening the country’s fiscal stance. The public balance deficit amounted to 52,509 million pesos, a smaller figure than that authorized by Congress in December 1998. Hence, the public deficit/GDP ratio was 1.14 percent, lower than the 1.25 percent of GDP deficit forecasted at the beginning of the year.

This favorable result is explained by lower privatization-related public income, as well as increased BM operation costs, which were substituted by larger oil-related income, and lower foreign debt servicing costs, derived from the peso appreciation. The strengthening of the fiscal stance also increased domestic savings, thus increasing private/business sector investment, and contributed to the reduction of inflation and interest rates.

MEDIUM-TERM OUTLOOK

Mexico is an open economy with sharp income inequalities that have to be overcome. In this sense, the Mexican government’s main economic objectives are to attain a high and sustainable annual growth rate, with inflation kept within single digits, and to

turn these achievements into a better standard of living for the Mexican population. Another important goal is to achieve a successful transition into the next administration after this year's presidential elections.

The macroeconomic program for the year 2000 is intended to lower the inflation rate to 10 percent, with the goal of making it converge with that of our main trading partners no later than 2003. Expected GDP growth for 2000 is 4.5 percent, supported by an increase in gross fixed investment and sustained non-oil export growth. Growth for 2001 is forecast at 5.0 percent.

Due to high growth rates and enhanced access to international capital markets, the current account deficit is poised to increase somewhat to 3.1 percent of GDP in the year 2000. However, more than 70 percent of any such deficit will be financed through FDI, while the rest will be covered through medium- and long-term foreign debt. The public sector deficit is forecast to decrease to 1 percent of GDP in 2000, while the primary fiscal surplus will increase to 2.9 percent of GDP. Net foreign debt, in turn, will remain stable at 25.2 percent of GDP.

So far, it seems that Mexico is on track for reaching its year-end objectives. For instance, by April 2000 the yearly inflation rate stood at 9.73 percent, already below the target for the whole year, while yearly GDP growth in the first quarter of 2000 was 7.9 percent. As far as the trade balance is concerned, in the first quarter of 2000, the commercial deficit was US\$1.3 billion. Furthermore, the price of the Mexican oil mix was 25.6 US dollars per barrel (dpb) while the average for 1999 was only 15.6 dpb, thus easing fiscal pressures.

Finally, it is worth mentioning that the Mexican government accords high priority to the strengthening and consolidation of the banking system, in order to put it on a more secure footing and enable it to operate in a more volatile global environment. The recent improvements in the Mexican financial system are a key component of the second-generation structural reform process. A strong and healthy banking system is needed to increase domestic savings to levels compatible with Mexico's investment needs and to channel those savings, under competitive conditions, to all sectors of the economy.

The government is committed to apply fully the Basle Core Principles for effective banking supervision. Loan classification and provisioning rules will be strengthened further and will be consistent with a minimum general provision on standard loans. The definition of regulatory capital and connected lending will be revised, and minimum guidelines on banks' internal controls will be issued. The National Banking and Securities Commission (CNBV) will update banks' accounting principles, will strengthen monitoring of connected lending, banks' risk management practices, compliance with anti-money-laundering laws, and will further improve disclosure of banks' information. The strengthening of the Mexican financial system is a key element in the efforts to reduce the economy's vulnerability to external shocks.

NEW ZEALAND

GROSS DOMESTIC PRODUCT

Following recession in the first half of 1998, the New Zealand economy has recovered to grow at a robust rate. The second half of 1999 saw a particularly strong performance with growth running at an annual rate of around 10 percent. In 1999 as a whole, the economy expanded by 3.4 percent in annual average terms.

Monetary conditions eased considerably from early 1997, setting the stage for recovery. In 1999, growth was bolstered by the pick up in global economic conditions as well as favourable growing conditions for the agricultural sector.

Growth in 1999 was broad-based. Household spending was supported by lower interest rates and an improving labor market. Consumer spending rose by nearly 4 percent in the year and spending on residential investment rose by around 20 percent. While business investment made little contribution to growth over 1999, inventory changes accounted for about a third of the growth in 1999, some of which could have been related to Y2K.

Exports were up by 5.0 percent in 1999, the strongest annual growth rate since the mid-1990s. Primary exports (around a third of New Zealand's exports) have been recovering from the effects of two years of drought and the impact of the Asian crisis. As a whole, primary exports were up around 4 percent, but growth was concentrated in the second half of the year, which saw growth in primary exports reaching nearly 20 percent. In the second half of the year, the agricultural sector bounced back from the effects of the 1998-1999 drought and was also buoyed by very favourable weather conditions. Manufactured exports and tourism both posted solid growth in 1999 benefiting from a lower exchange rate as well as improving global growth. A rebound in visitors from the Asian region as well as one-off events such as the millennium celebrations added impetus to the tourism sector.

On the production side, the primary sector, the goods-producing sector and the services industries all made solid contributions to growth in 1999. The year was, however, one of contrasting halves. In the first half of 1999, growth in the service industries well exceeded the negative growth in the primary sector and the flat production in the goods-producing sector. In contrast, the second half of the year saw the opposite, with a marked pick up in primary and manufacturing production. Again, this reflects the turnaround in the fortunes of the agricultural sector. Strong agricultural production in the final two quarters of the year had flown on effects to the primary food processing industry and the transport sector. Within the service sector, the communications industry recorded the strongest growth in 1999, posting an annual growth of 15 percent. This sector has been a strong performer for several years now.

The latest quarterly data showed real production GDP fell by 0.7 percent over the June 2000 quarter, with the annual GDP 4.5 percent higher. On the production side, only a couple of services sector showed any growth – notably wholesaling activity and the communications industry. Construction activity detracted significantly from growth following the surge of the last quarter, while manufacturing was adversely affected by weak agricultural production and soft domestic demand.

The latest quarterly GDP outturn reinforces the picture of a soft domestic economy as painted by other indicators as such confidence and employment. However, conditions remain conducive for strong growth in the tradeables sector, with the latest indicators continuing to suggest a rebalancing in activity away from domestic to external sector growth. Ultimately this should filter through to the domestic economy making for solid economic growth.

INFLATION

Inflationary pressures were surprisingly weak over the second half of 1999. The effect of higher petrol prices, as a result of the sharp rise in international oil prices, was broadly offset by the effect of a substantial decline in fresh fruit and vegetable prices (due to a return to more favourable growing conditions). After stripping out these effects, “core” inflationary pressures were rather muted. All told, the consumer price index rose by 0.6 percent over the second half of 1999, so that, when measured on a consistent basis, annual inflation stood at 0.5 percent.¹

The first quarter of 2000 saw a lift in general inflationary pressures. The consumer price index rose by 0.7 percent in the quarter, and annual inflation (when measured on a consistent basis) rose to 1.7 percent. Higher petrol prices again made their mark, while there was some evidence to suggest that the incidence of price rises had become more widespread in the first quarter.

More recently, second quarter of 2000 CPI rose by 0.7 percent. However, the rise in quarterly inflation was narrowly concentrated in petrol price rises and tobacco products (reflecting an increase in excise taxes). These two factors are also expected to make a significant contribution to the September quarter inflation outturn. Looking towards the end of this year, these twin effects may lead to a sharp spike in inflation, with the annual consumer price index likely to peak above the top of the RBNZ’s 0-3 percent inflation target range.

EMPLOYMENT

Stronger growth in the economy in 1999 was reflected in an improving labour market. In December 1999, employment growth was up 2.7 percent over a year ago with full-time employment growth accounting for most of the job growth. The unemployment rate fell from 7.7 percent in December 1998 to 6.3 percent by the end of 1999. Furthermore, the latest labour market data showed the unemployment rate edging down further to 6.1 percent in the June 2000 quarter. However, this quarterly fall reflects an unusually sharp decline in the labour force participation rate, which is likely to be reversed in the quarters ahead. Over the first half of 2000, employment growth has remained reasonably soft, consistent with the projected slowing in activity growth.

¹ The September 1999 quarter saw a change in the way in which the CPI is defined. Primarily, the new definition saw interest rates and land prices removed from the CPI. Consequently, from the period September 1999 to March 2000, annual CPI inflation is made up of some of the old definition of the CPI and some of the new definition of the CPI. Therefore, a consistent definition of annual inflation is referred to, a definition that sees interest rates and land prices always removed.

In New Zealand's previous economic cycle, the unemployment rate troughed at around 6 percent. This, together with some signs of emerging skill shortages, suggests a reasonable degree of tightness in the labor market for this stage of the cycle. Net migration which helped boost labor force growth in the mid-1990s period was negative during 1999 and is not expected to turn around quickly.

As yet wage growth has remained subdued with annual wage growth running at 2 percent in 1999, a slowdown on the 3-percent growth is seen at the end of 1998. However, wage growth tends to lag employment trends, and some wage pressure is expected to emerge.

CURRENT ACCOUNT

The current account balance for the year to June 2000 recorded a deficit of 7.2 percent of GDP. While this was up from the 7.1 percent of GDP deficit recorded in the March quarter, the trend current account has been improving since December 1999. In particular, the trend current account was 5.9 percent of GDP using annualised rates in the June quarter, down from the deficit of 7.4 percent of GDP recorded for the December 1999 quarter. On the whole, the latest outturn supports the current forecast for an improving current account deficit as a result of the projected turnaround in the goods and services balance from deficit to surplus.

Looking further ahead, a projected increase in the trade balance is expected to drive the improvement in the overall current account deficit. A continuation of strong growth in the world economy and the stimulatory level of the NZ dollar is expected to assist exporters to expand markets. Strong growth in tourist arrivals is expected to lead to some improvement in the balance on services over the coming year.

EXCHANGE RATE

The exchange rate generally remained weak in 1999. On a trade weighted basis, the exchange rate ended the year at around the 55.5 mark, down slightly from where it stood at the start of the year, but down significantly from its peak of around 69 in early 1997. Against the US dollar, the NZ dollar lost about ½ US cent in 1999 to stand at just over 52 US cents at the end of 1999 (this compares with a peak of just under 70 US cents in early 1997).

Since the start of 2000, the exchange rate has come under significant downward pressure. By early October, the exchange rate, on a trade-weighted basis, had fallen by around 13 percent, and was trading around the 47 level. Over the same time period, the NZ dollar has lost around 11 US cents, to be just over the 40 US cents mark.

GROSS EXTERNAL DEBT

New Zealand's total gross external debt remained unchanged at \$87 billion in the year to March 2000 compared with the year to March 1999. After generally increasing since the beginning of the series in 1989, the net liability position has remained relatively steady in levels terms more recently, falling slightly from \$89 billion in March 1998, to stay steady at \$87 billion for the last two years. The steady net liability level combined with strong economic growth over 1999 has led to the fall in New Zealand's net liabilities as a proportion of GDP.

FISCAL POLICY

Following a prolonged period of fiscal deficits New Zealand has consistently achieved operating surpluses since the fiscal year ending June 1994. The initial improvement in the fiscal balance over the mid-1990s period reflected a growing economy and firm control over expenditure. Government operating expenses have been reduced as a percentage of GDP from 41.6 percent in 1992-1993 to 34.6 percent in 1999-2000.

Over recent years the fiscal surplus has fallen back from above 3 percent of GDP in fiscal years 1995 and 1996 to 1.4 percent of GDP in 2000. Slower economic growth as well as tax reduction packages help explain the reduction in the fiscal surplus. This reduction, however, was moderated by state asset sales.

Net government debt has fallen from 49 percent of GDP in 1992 to 1993 to 21 percent in 1999 to 2000. Debt repayments have been financed from operating surpluses and asset sales proceeds. From 2001 to 2002 onwards, it is assumed that surpluses will contribute to building up financial assets to begin pre-funding future superannuation costs as well as paying off debt.

MONETARY POLICY

The Reserve Bank of New Zealand is an independent central bank and by the Reserve Bank Act 1989 is charged with maintaining price stability in New Zealand. The Act requires that there be a Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank. Initially, the Policy Targets Agreement required the Bank to maintain inflation in the range of 0 percent to 2 percent over any 12-month period. The range was increased to 0 percent to 3 percent in December 1996. The current Policy Targets Agreement, signed with the new Labour/Alliance Coalition Government in December 1999, also clarifies that in pursuing its price stability objective, the Bank shall seek to avoid unnecessary instability in output, interest rates and the exchange rate.

When it comes to implementing monetary policy the Reserve Bank uses an official cash rate target. This was introduced in March 1999 and was set at 4.5 percent. In 1998, interest rates fell with short-term interest rates falling from a peak of 10 per cent in mid-1998 to around 4.5 percent in early 1999. In contrast, short-term interest rates rose in 1999 and early 2000 in the face of a strengthening economy. The official cash rate currently stands at 6.5 percent. Despite the rise in short-term interest rates, overall monetary conditions in New Zealand remain quite stimulatory due to weakness in the exchange rate.

OUTLOOK

Conditions remain conducive for continued growth in the New Zealand economy. The world backdrop is positive and the current low exchange rate will provide a source of stimulus.

The economy has, however, slowed from the exceptionally strong growth rates seen in the latter part of 1999. Growth in the second half of 1999 was boosted by some one-off factors such as the rebound in agricultural production and Y2K effects that have unwound over the first half of 2000. Moreover, the recent observed sharp declines in both consumer and business confidence further highlights the risk of a slowing in activity going forward.

On the pricing front, the impact of higher imported inflation on the back of the weaker NZ dollar, together with the sharp rise in the cost of crude oil, are expected underlie a rise in consumer prices. In order to ward off such inflationary pressures, monetary conditions are expected to tighten further. Interest rates, already up 200 basis points since the beginning of 1999, are expected to rise further over the next year. Following annual average growth of around 4 percent in 2000, the economy is expected to slow to around 3 percent in 2001 and 2 percent in 2002.

Over the coming year, annual consumer price inflation is expected to push above the Bank's 0-3 percent inflation target. Nevertheless, abstracting from one-off influences on the price level, the forecast tightening in monetary conditions is expected to keep inflation under control over the next few years. Inflation is expected to settle back down to around 2 percent per annum.

The export sector is expected to be a key driver of growth over the next few years. Solid volume growth for both goods exports and tourism along with rising commodity prices are behind an expected reduction in the current account deficit. The current account deficit, currently equivalent to 7 percent of GDP, is expected to fall to around 5 percent of GDP over the next two years.

PERU

GROSS DOMESTIC PRODUCT

In 1999, the Peruvian economy began to recover from the negative effects of three severe external shocks: *El Niño*, the deterioration of the terms of trade that followed the Asian Financial Crisis, and the international financial market turbulence.

Gross domestic product (GDP) growth increased from -0.4 percent in 1998 to 1.4 percent in 1999, due to the expansion of agriculture, fishing and mining. The expansion registered in the primary sectors was mainly due to the favorable weather conditions, which had a positive effect on fishing and agriculture, and to the rise in gold production.

On the global supply and demand sides, GDP growth responded to an increase in exports of goods and services (5.4 percent), while domestic demand declined by 2.6 percent, mainly due to an 11.8 percent decrease in investment. However, in the last quarter of 1999, domestic demand rose by 3.7 percent due to the recovery of private consumption.

INFLATION

In 1999, the rate of inflation was 3.7 percent, the lowest since 1960 and the second lowest in the last 60 years. Also, this level is below the lower end of the inflation target range (5 – 6 percent) established in the economic program signed with the International Monetary Fund (IMF).

EMPLOYMENT

Unemployment in urban areas was, at 7.7 percent, slightly lower than in the previous year.

CURRENT ACCOUNT

The current account deficit amounted to US\$1,817 million, equivalent to 3.5 percent of GDP compared with 6.4 percent of GDP in 1998. The smaller current account deficit reflected a US\$1,850 million drop in the trade balance deficit. This result was due to both the growth of exports (6.2 percent) and the fall of imports (-18.2 percent). The expansion of exports was mainly due to the rise of traditional exports (11.6 percent), such as mining and fishing exports, which grew by 9.5 and 46.5 percent, respectively, and non-traditional agricultural exports (34.2 percent). Mineral exports increased due to higher export volumes of gold (34.2 percent), despite the decline in international metal prices. Fishing and agricultural exports were influenced by the greater activity in these sectors due to better weather conditions. Imports declined basically due to the lower domestic demand.

CAPITAL INFLOWS

In 1999, net capital inflows amounted to US\$778 million (1.5 percent of GDP), a US\$1,305-million decrease from 1998, mainly due to the lower external financing needs of the banks (US\$1,272 million) associated with a lower domestic demand. It should be stressed that long-term private capital inflows, excluding privatization revenues, continued to finance the current account deficit.

EXCHANGE RATE

Peru maintains a floating exchange rate regime. In 1999, the Peruvian currency (nuevo sol) depreciated by an average of 15.4 percent in nominal terms and 10.9 percent in real terms.

FISCAL POLICY

In 1999, the weakness in domestic demand led to a significant reduction in tax collections, and central government current revenue declined to 14.5 percent of GDP, compared with 15.7 percent of GDP in 1998. As a result, the fiscal deficit increased to 3.0 percent of GDP. In order to reinforce the fiscal balance, the government enacted the Fiscal Responsibility and Transparency Law in December 1999. The main features of this law are:

Limitations

- The fiscal deficit cannot be above 1 percent of GDP. In the transition period, the deficit shall not exceed 2 percent of GDP in 2000 and 1.5 percent in 2001.
- The rate of growth of general government expenditure cannot be above the rate of inflation plus 2 percentage points.
- In election years, the deficit of the first semester cannot exceed 50 percent of the deficit projected for the year. Also, the non-financial general government expenditure for the first 7 months cannot be above 60 percent of the expenditure foreseen for the year.

Stabilization Fund

- In order to moderate the expenditure in boom years, tax earnings in excess of 0.3 points of GDP above the average of the last three years will be deposited in a stabilization fund. Part of the earnings from privatization will also accrue to this fund.
- These resources can be used in years in which tax earnings decline by more than 0.3 percent of GDP or in case of an emergency. The cap to the deficit can be raised only to 2 percent of GDP.

Transparency

- The Ministry of Finance publishes a three-year Macroeconomic Framework three months before the presentation of the following year's budget draft.
- The Central Bank issues an evaluation of the consistency of the Macroeconomic Framework with its objectives and the balance of payments outlook.
- The Ministry of Finance issues every semester an assessment of the accomplishment of the objectives and targets established in the Macroeconomic Framework.

MONETARY POLICY

The monetary policy continued to focus on price stability and aimed at bringing inflation down to industrialized economy levels. Control of the intermediate target—the expansion of the monetary base— was conducted in the context of a floating exchange rate and market-based interest-rate determination.

Money supply growth (1.7 percent) was driven by the increase in the average monetary base (6.7 percent), which was partly offset by the decrease in the money multiplier (4.7 percent).

During 1999, total credit of the banking system to the private/business sector grew by 2.9 percent in real terms, down from 14.1 percent in 1998. The decrease in the total credit to the private/business sector reflects the conservative behavior of the banks caused by the credit risk and the weakness of the solvency indicators of the financial system.

Net international reserves (NIR) decreased by US\$780 million during 1999, to US\$8,404 million at the end of the year. This level is equivalent to 5 times the monetary base, 2.1 times the domestic liquidity, 63 percent of the total liquidity, 15 months of imports of goods, 1.2 times the debt due within a year and 1.8 times the short-term foreign debt.

In order to increase the transparency of the monetary policy, the Central Bank began publishing its Monetary Program, starting in January 2000.

MEDIUM-TERM OUTLOOK

Peru has completed the first year of its third Extended Fund Facility Agreement with the IMF. Given that 2000 is an election year, the government signed a letter of intent only for the first half of the year.

The economy is expected to grow between 4 and 5 percent in real terms in 2000 and 6 percent in the medium-run. The inflation target range for 2000 is 3.5 to 4.0 percent, and the inflation rate is expected to reach international levels in the following years.

The current account deficit, which is forecast at 4 percent of GDP for 2000, will continue to be financed by long-term capital inflows.

The fiscal target is to reduce the deficit to 1.9 percent of GDP in 2000 and to attain equilibrium in the medium-run.

PHILIPPINES

REAL GROSS DOMESTIC PRODUCT

In 1999, the Philippines recovered from the output decline caused by the currency and financial turbulence that hit East and Southeast Asia starting in July 1997. Gross domestic (GDP) growth, spurred by the increase in government and personal consumption as well as exports, rebounded from -0.6 percent in 1998 to 3.3 percent in 1999. The government's pump-priming activities contributed to the recovery as government consumption went from -1.9 percent in 1998 to 5.3 percent in 1999. Meanwhile, total exports of goods and services turned around from a decline of 21 per cent in 1998 to a growth of 3.6 percent in 1999. The growth in total exports stemmed largely from the gain in merchandise exports (8.7 percent) which was bolstered by increased exports of finished electrical machinery semiconductors and electronics, ignition wiring harness and other manufactured products.

On the production side, agriculture, services and industry all joined the expansion with growth rates of 6 percent, 4.1 percent and 0.9 percent respectively, in 1999. Higher growth in the gross value added (GVA) of the economy's major crops including palay, corn, sugarcane and banana largely contributed to the 6.4 percent growth of agriculture and fishery. Agricultural gross value added (GVA) had decreased by 6.5 percent in 1998 on account of the *El Niño*. Favorable weather conditions, investments in irrigation systems, proper usage of farm inputs, and increased use of certified seeds boosted palay production by 37.8 percent in 1999. Increases in the GVA of private services (5.8 percent), transportation, communication and storage (5.3 percent) and trade (4.9 percent) contributed to the steady performance of services which grew from 3.5 percent in 1998 to 4.1 percent in 1999. The industry sector got a lift from manufacturing, which grew 1.6 percent to overcome the decline of 1.1 percent in 1998. Mining and quarrying, however, declined 8.4 percent, in view of depressed world market prices of metals, suspension in operation of some mining companies and the economic slowdown of importing countries.

The economy continued to perform well in the first half of 2000 recording a growth of 3.9 percent. This was mainly attributed to the 12.3 percent growth in exports of goods and services. Merchandise exports increased by 15.8 percent due largely to the increase in exports of semiconductors and electronic microcircuits (21.1 percent) and garments (11.3 percent). Personal consumption expenditures also increased by 3.2 percent arising from higher household expenditures on electrical appliances, increased cellular and landline phone subscriptions, and higher expenditures on utilities (i.e., fuel, light and water). In contrast, government expenditures contracted by 0.5 percent in the first half as a result of continued cuts in maintenance and other operating expenses to maintain the targeted deficit for the year.

Industry rebounded to register a growth of 4.1 percent against -1.5 percent in the first half of 1999. Manufacturing grew by 6.1 percent during the first half of 2000 on account of higher growths attained in electrical machinery (31.6 percent), paper and paper products (28.9 percent) and transport equipment (28.2 percent). Mining and quarrying turned around from a -14.9 percent a year ago to a 14.1 percent increase in the first semester of 2000. The increase was largely due to the substantial increases in gold, nickel and crude oil production.

Reflective of the rapid change in technology, the communications sub-sector grew by 16.1 percent in the first half of 2000. Increases in the subscriber base of wireless and landline communication services, and the emergence of data and other network services were the main source of growth. As a whole, the services sector grew by 4.4 percent in the first semester.

The agriculture sector continued to recover from the effects of *El Niño* and *La Niña* weather disturbances which led to the better than expected increase in production in the second quarter of the first semester of 2000. Production of palay, the economy's staple crop, grew by 3.2 percent. Additional fruit bearing plants and good crop maintenance also resulted in increase in the production of banana by 11.4 percent. Fishery production grew by 0.8 percent.

INFLATION

Despite the inflationary pressures exerted by the series of oil price increases, wage and transport fare hikes, inflation went down to an average of 6.6 percent in 1999, compared to 9.8 percent in the previous year, and below the government's inflation target of 7 percent.

The country's inflation rate continued to go down registering at 3.4 percent for the first half of 2000. The increase in agriculture production in the first semester resulted in an inflation rate of just 0.73 percent for food, beverage and tobacco compared to 8.48 percent in the first half of 1999. The minimal increase in food prices together with lower price increases for clothing (2.45 percent) and housing and repairs (6.12 percent) offset the increase in the inflation rate recorded for fuel, light and water from 5.25 percent during the first half of 1999 to 8.95 percent during the first half of this year.

EMPLOYMENT

Total employment grew 3.8 percent in 1999. The total number of employed people increased from 27.9 million in 1998 to 29 million in 1999, an increase in the employment rate to 90.3 percent from 89.9 percent. Employment in agriculture increased by 6.5 percent, and services by 3.5 percent. Meanwhile, the overall unemployment rate decreased to 9.7 percent in 1999 from 10.1 percent in 1998. In absolute numbers, the unemployed decreased from 3.143 million to 3.102 million in 1999.

For the first half of 2000, however, the unemployment rate increased to 11.6 percent compared to 10.4 percent during the same period in 1999. Except for the services sector which registered increased employment by 3.4 percent, agriculture and industry including manufacturing registered decreases in employment for the first half of 2000. The decrease in employment in agriculture is mainly seasonal in nature as the second quarter coincides with the post-harvest rest period for farmers.

TRADE ACCOUNTS

The recovery was accompanied by an increase in the current account surplus, which expanded 369 percent from US\$1.5 billion in 1998 to US\$7.2 billion in 1999. Exports of goods grew 19 percent, outpacing imports' 4.1 percent growth, resulting in a surplus of US\$4 billion, compared to the deficit of US\$28 million in 1998. Manufactured products constituted the bulk of Philippine exports with a share of 89.4 percent. Exports of

electrical and electronic equipment/parts and telecom remained the top export items, which grew 23.5 percent in 1999 followed by machinery and transport equipment, which expanded by 49.3 percent. Likewise, service trade receipts exceeded payments by US\$2 billion in 1999 for an increase of 110.8 percent over the previous year's surplus of US\$1.1 billion.

Net foreign investments declined by 27.2 percent as a result of a reduction in direct investments, new foreign investments and reinvested earnings by an average of 44 percent in 1999. However, portfolio investments increased by 93.9 percent during the same period from higher placements which increased 206.9 percent. Despite the drop in net investments, the overall balance of payments posted a surplus of US\$3.8 billion in 1999 compared to US\$1.4 million in 1998. The improved external payments position allowed the government to build-up its international reserves to US\$15.1 billion, 39.8 percent higher than the previous year's level of US\$10.8 billion.

The current account surplus further increased growing by 24 percent from US\$2.9 billion in the first half of 1999 to US\$3.6 billion in the first semester of 2000. Exports of goods and services grew by a hefty 362.1 percent to reach US\$1.4 billion in the first half of 2000 as it recovers from a US\$546 million decline a year earlier. However, the economy's capital and financial account balance declined by 170 percent due to decreases in direct investment (71 per cent) and portfolio investments (110.7 percent). Overall the BOP position as of the first half of 2000 stands at US\$205 million compared to US\$2.9 billion in the first semester of 1999.

GROSS EXTERNAL DEBT

Total foreign exchange liabilities in 1999 went up to US\$52.2 billion from US\$47.8 billion in 1998. Around US\$307 million (P 120 billion) in foreign borrowings was utilized to finance the national government's budgetary deficit of P 111.7 billion in 1999, redeem some of its debts and build up its cash position. Medium- and long-term loans comprised the bulk of total liabilities with a share of 89 percent compared to short-term loans with a share of 11 percent. The public sector was the biggest borrower with a 55.6 percent share in total liabilities followed by the private/business sector at 25.4 percent and the banking sector with 19 percent. The economy's total foreign exchange liabilities increased by US\$205 million from US\$52.2 billion as of end-1999 to US\$52.4 billion as of the first quarter of 2000.

EXCHANGE RATE

The Philippine peso exhibited greater stability in 1999, trading in a narrower range against the dollar compared to the previous year. The exchange rate averaged at P 39.09/US\$, appreciating by 4.4 percent from the 1998 average of P 40.89/US\$. The appreciation was mainly due to foreign exchange inflows through the equities market, especially in the first half of the year, as well as the slack corporate dollar demand from restrained industrial activity. Net direct investments and net portfolio investments in the first half of 1999 grew by 32.6 percent and 71.2 percent, respectively. For the first half of 2000, the Philippine peso averaged P 41.26/US\$, a depreciation of around 7.6 percent as against P 38.34/US\$ of the first half of 1999.

FISCAL POLICY

Government spending rose by 15.2 percent to P 590.16 billion in 1999 resulting in a deficit in the government's cash operations by P 111.66 billion. The government's pump-priming activities caused government expenditures to exceed the target level of P 576 billion by P 14.2 billion. Meanwhile, the slow growth in manufacturing and other industrial sectors contributed to a narrower tax base and lower collection performance. Consequently, revenue collection only increased by 3.5 percent in 1999 (P 478.5 billion), lower by P 12.2 billion than the 1999 target level of P 490.7 billion.

Government expenditures exceeded total government revenue collection by P 47.69 billion in the first half of 2000 as government tax revenues increased by only 5.5 percent from P215.95 billion in the first half of 1999 to P 227.87 billion. The total revenue collection was likewise below the programmed level of P 268.26 billion for year 2000. The lower revenue collection was caused by the shortfall in privatization proceeds which only amounted to P 1.36 billion against the programmed P 15.45 billion, as well as reduced collections by the Bureau of Internal Revenue which grew by only 2.9 percent during the first semester. Sixty percent of total government's expenditure was allocated for the use of the national government, 20 percent for interest payments and 18 percent for allotment to local government units.

MONETARY POLICY

Domestic liquidity grew by 19.3 percent in 1999. A more accommodative monetary policy through a low interest rate environment helped achieve the better than expected inflation rate in 1999 at 6.6 percent. Measures to reduce intermediation cost and to spur bank lending by the private/business sector were implemented. The reserve requirements were reduced from 17 percent in October 1998 to 12 percent in July 1999. The overnight borrowing rate by the central monetary authority (Bangko Sentral ng Pilipinas – BSP) was also cut to 8.75 percent in November 1999 from 13.5 percent as of December 1998, and its lending rate to 11.8 percent in December 1999 from 15.4 percent in December 1998. Further, the application of the 2 percent general loan-loss provision was relaxed, while the Exporters' Dollar Facility was expanded to include yen-denominated loans.

New regulatory guidelines enhanced the stability of the banking system. Disclosure requirements for banks, entailing quarterly information on non-performing loans, amount of specific and general loan-loss reserves, return on equity, and loans to insiders, have been widened to include even those that are unlisted at the Philippine Stock Exchange. Banks were also required to increase their capitalization in 2000 with accompanying remedial actions and sanctions for banks with capital deficiencies. The Philippine Central Bank (BSP) has completed its first-generation early warning system for commercial banks which can predict a bank's capitalization ratio or solvency one year ahead. To promote consolidation, the BSP imposed an indefinite moratorium on the establishment of new banks except in cities and municipalities where there are no existing banking offices and under other special conditions.

In 2000, the government's monetary policy continued to aim for a decline in inflation and broad stability in foreign exchange while ensuring that interest rates are reasonably low to support economic growth. The exchange rate continued to be market determined and build

up of foreign reserves was pursued to the extent allowed by monetary and foreign exchange market conditions.

Likewise, the policies which were instrumental in supporting the country through the crisis of 1997 continued to be followed including implementation of prudent fiscal and monetary policies, liberalization and privatization of the banking sector, proactive management of external debt and progressive development of capital markets.

MEDIUM-TERM OUTLOOK

A fairly strong performance in GDP in 1999 highlighted by a robust growth in merchandise exports, expansion in output of the production sectors, i.e., agriculture, industry and services as well as a low inflation rate showed that the economy is well on track to achieve the government's growth and inflation targets. Further, based on a strong performance in the first half 2000, the Philippines is likely to achieve the target of at least 4 per cent growth in GDP for the whole of 2000. Agriculture, fishery and forestry is predicated to grow by 2.5 percent, industry by 4 percent, and services by 4.1 percent in 2000. The inflation rate is expected to be kept within single digit level at 5 percent.

For 2001, the GDP growth target will range from 4 percent to 5 percent. The growth for next year hinges on strong export growth, higher fiscal spending on capital outlays especially for foreign-assisted projects, and recovery of bank lending. Inflation is expected to increase in 2001 to 6 – 6.5 percent due to lagged effects of the increase in oil prices and the weaker peso in 2000, and the impact of the *El Nino* on food prices.

However, the government will continue to assess the impact of the peso-dollar rate, oil prices, and world interest rates on the economy and on the growth and inflation targets.

RUSSIA

GROSS DOMESTIC PRODUCT

GDP grew in 1999 by 3.2 percent, with industry as the main contributor to said growth. The volume of industrial production in comparison with the previous year increased by 8.1 percent, agricultural production by 2.4 percent construction by 5.4 percent and transport by 4.2 percent. However, a 3.2 percent decline in trade posted a negative influence on GDP.

In 1999, total consumption and private consumption experienced declines by 3.5 percent and 5.3 percent, respectively, over the previous year. The share of physical volumes of paid services for the population in the structure of final consumption of households increased by 1.4 percent.

INFLATION

Starting August 1999, the monthly rates of consumer prices were in the range of 1.2 to 1.5 percent. In 1999, consumer prices grew by 36.5 percent.

The rates of inflation in industry were higher than the rates of consumer prices growth. In 1999, the growth of prices in industry was 1.8 times more than the growth of consumer prices. The higher dynamics of prices in industry were influenced by the increased demand for domestic production, growth of deliveries in export, and growth of world prices for some Russian export goods.

EMPLOYMENT

Growth in the economy resulted in the improvement of the labor market situation. Both the number of officially registered unemployed and the rate of total unemployment have been on a downward trend since February 1999.

The number of unemployed (calculated in accordance with the method of the International Labor Organization) was reduced from 13.3 percent of the economically active population in the beginning of 1999 to 12.3 percent by the end of the year.

The rate of officially registered unemployed decreased from 2.6 percent of economically active population in the beginning of 1999 to 1.7 percent by the end of the year.

TRADE ACCOUNTS

Trade balance was at US\$34.3 billion in 1999. Russia's exports practically stabilized at the 1998 level with a 0.3 percent decline.

Imports into Russia in 1999 were reduced by 33.1 percent. The dynamics of the volume of imports were predestined by the effect of devaluation of the ruble and significant reducing of import prices. As a result, import volumes fell less than in value terms.

In 1999, US\$9.6 billion worth of foreign investments were infused into the Russian economy, 81 percent more than the 1998 level. The volume of foreign direct investments was US\$4.3 billion in 1999, about a 27 percent growth over the 1998 level.

GROSS EXTERNAL DEBT

In 1999, the external debt of Russia amounted to US\$158.8 billion. This includes credits received on the bilateral base (US\$64.1 billion), commercial credits (US\$56.8 billion), credits of international financial organizations (US\$21.8 billion), and other credits (US\$16.1 billion).

The main part of the debt was inherited by Russia from the Soviet Union. Russia made the preliminary agreement on February of the current year with the London Club on the restructuring of part of the debt, which had been inherited from the Soviet Union. As a result of negotiations, US\$10.6 billion had been written off from a total debt equal to US\$31.8 billion. In addition, consent was given to redeeming the remainder of the debt (amounting to US\$21.2 billion) with a delay, until 2008, for the beginning of payments.

The rest of the Soviet debt to the member-countries of the Paris Club is more than US\$40 billion.

EXCHANGE RATE

In 1999, Russia pursued the floating ruble exchange rate policy. The beginning of 1999 saw an increase in demand for foreign currency in the interbank market. Starting late March, the ruble acquired a stable exchange rate of 24 to 25 rubles per US dollar, which stayed the same through the period of April-August 1999. In the fourth quarter, the dynamics of the US dollar to ruble exchange rate was rather smooth and predictable.

Over 1999, the official exchange rate of the US dollar to the ruble fixed by the Bank of Russia increased by 31 percent, from 20.65 to 27.00 rubles for a dollar. The index of real exchange rate of the ruble to the US dollar (factoring the increase in prices on consumer goods) went up 1.5 percent over 1999.

FISCAL POLICY

Federal budget revenues in 1999 amounted to 13.7 percent of GDP. The key factors that determined the dynamics of federal budget revenues were: an increase in industrial production, better tax collection and favorable energy prices on world markets.

Federal budget expenses totaled 14.9 percent of GDP in 1999. The federal budget deficit in 1999 amounted to 1.2 percent of GDP with primary profit equaling 2.4 percent of GDP.

MONETARY POLICY

In 1999, the situation on the exchange market was determined by, essentially, an excess of foreign currency proposal above demand. It was conditioned mainly by a high positive trade balance.

The activity of credit organizations in a domestic market of government borrowing has increased. The decrease in the Bank of Russia's interest rate from 55 percent to 35 percent became the positive factor in the growth of the Russian securities demand.

In 1999, drawings from the Russian investors on a domestic securities market were restored. There was only partial refunding of a state debt which was made out of Treasury bills. In total, the auction yield of Treasury bills under the satisfied applications has compounded 20.1 percent annually.

The operations on the financial market of commercial banks stimulated an increase of their activity in the sphere of corporate securities.

MEDIUM-TERM OUTLOOK

The growth of GDP in 2000 is estimated to be 5.5 percent, industrial production at 7.5 percent, agricultural production at 3 percent, and investments to fixed capital at 9 percent. The rate of inflation is projected at 20 percent.

The main goals of economic policy for 2000 and 2001 are hastening of economic growth, step-by-step recovery of the real money income of the population in conditions of a steady decrease of inflation, a maintenance of effective protection of vulnerable sectors of the population, and the development of market and institutional infrastructure.

SINGAPORE

GROSS DOMESTIC PRODUCT

The Singapore economy staged a strong recovery in 1999. After an anaemic 0.4 percent growth in 1998, economic output expanded by 5.4 percent in 1999. Growth was led mainly by the rapid recovery in external demand, which expanded by 6.7 percent after the 4.4 percent decline in 1998.

The increase in the exports of merchandise goods was led by buoyant electronics and chemicals exports. With the pick-up in regional demand, services exports also improved on account of brisker freight and port services and increased tourist arrivals.

Domestic demand rose by 6.5 percent, reversing the contraction of 7.3 percent in 1998. This was boosted by the improvement in consumption expenditure on account of positive consumer sentiments, as well as by the rebuilding of inventories. Capital spending, however, continued to shrink primarily due to the slump in private sector construction activity.

From the sectoral perspective, the manufacturing, transport and communications, and wholesale and retail trade sectors provided the main impetus for growth. Except for the construction and business services sectors, the performance of all other major sectors improved in 1999 compared to a year ago.

Riding on the strength of the global electronics demand and the regional recovery, the manufacturing sector staged a strong turnaround in 1999 to grow by 14 percent. The electronics and the chemicals industries chalked up double-digit growth of more than 20 percent. The former was driven by robust growth in the telecommunication and semiconductor segments, while the latter expanded on the back of strong demand for pharmaceutical and industrial/specialty chemicals from both the US and Europe.

The construction sector contracted by 12 percent in 1999, down sharply from a growth of 4.4 percent a year earlier. This was expected, given the sharp decline of 35 percent in contracts awarded in 1998. Construction demand remained weak in 1999, as contracts awarded fell further by 23 percent to \$11.7 billion, led by a sharp fall in public sector contracts.

The transport and communications sector grew by 7.1 percent in 1999, up from 5.5 percent in 1998. Air cargo and the number of air passengers handled grew respectively by 17 percent and 8.7 percent, in line with the improvement in regional trade and tourism. This contrasted sharply with the declines of 3.8 percent and 5.4 percent respectively in 1998. In the sea sub-sector, total sea cargo handled and total container throughput rose by 4.3 percent and 5.3 percent respectively in 1999, compared with -4.6 percent and 7.1 percent in the preceding year.

In line with the swift rebound in the domestic and regional economies, the wholesale and retail trade sector staged a 7.1 percent recovery in 1999, reversing the 4.1 percent decline in 1998. The upturn in the regional economies lifted entrepot trade, and was

also a major contributing factor behind the 11 percent increase in visitor arrivals. Domestic demand also benefited from the improvement in consumer confidence. Overall retail sales volume grew by a robust 17 percent, up from -7 percent in 1998.

Similarly, the recovery in visitor arrivals and improving consumer sentiments helped the hotels and restaurants sector expand by 3.7 percent in 1999, reversing the 3.7 percent fall in 1998.

The financial services sector registered flat growth in 1999, compared to -8.1 percent in 1998. The improvement was partly due to the surge in stock market activity over a large part of the year. Reflecting the more upbeat market sentiments on the domestic and regional economic outlook, stock market turnover rose 100 per cent and 110 percent in value and volume terms respectively. Fund management activity also posted robust growth. However, other key segments remained weak. Both the domestic and offshore banking markets contracted in 1999, as loans and advances to both domestic and regional non-bank customers continued to decline throughout the year. In the foreign exchange market, the average daily turnover continued to be weak.

The business services sector grew marginally by 0.1 percent in 1999, slower than the 5.1 percent in 1998. Although computer and related services as well as the professional services continued to do well, growth was dragged down by the weakness in real estate services.

INFLATION

The consumer price index registered flat growth in 1999, reversing the decline of 0.3 percent in 1998. Higher costs of food, miscellaneous items, education and healthcare outweighed lower costs of housing and transport and communications.

EMPLOYMENT

The labour market benefited from the upturn in the economy. Total employment rebounded with a net job gain of 39,900, a sharp reversal from the net loss of 23,400 jobs in 1998. The employment growth was broad-based across all major industries, with the exception of the construction sector. With the pick-up in business demand, the number of retrenched workers shrank by half to 14,600 from a record of 29,100 in 1998. The manufacturing sector accounted for 55 percent of the total retrenchment, mainly from the electronics industry. The relatively higher number of retrenchment compared to pre-crisis period reflected the continual restructuring and consolidation in certain key manufacturing segments, notably in the disk drive industry, where margins have dropped significantly due to keener competition.

Although the quarterly seasonally adjusted unemployment rate was on a downward trend, easing to 2.9 percent in December 1999 from a high of 4.3 percent in December 1998, the average unemployment rate for the whole year of 1999 was 3.5 percent, slightly higher than the 3.2 percent in the preceding year. This was due to the relatively lower unemployment rate in the earlier half of 1998, before the full effects of the economic crisis were felt in the labour market.

EXTERNAL TRADE

Singapore's total external trade rebounded by 8.1 percent in 1999, a sharp recovery from the 7.5 percent contraction a year ago. Total trade reached \$382 billion, back to the level in 1997. Sustained recovery of the crisis-hit Asian economies, together with the strengthening of global demand for electronics, telecommunication and chemical products, led to a 17 percent surge in the second half of 1999, which outweighed a marginal decline of 0.9 percent during the first half of the year. Total trade in volume terms experienced a similar sharp rebound, up 7.4 percent, compared to -6.7 percent in 1998. Export volume rose by 5.4 percent, with domestic exports and re-exports growing by 8.1 percent and 1.6 percent respectively. Reflecting the improved domestic consumption and increased industrial activity, import volume also expanded by 9.5 percent in 1999.

BALANCE OF PAYMENTS

Singapore's overall balance of payments recorded a surplus of \$7.3 billion in 1999, compared with \$5 billion in 1998. The overall balance was boosted by an increase in the current account surplus to \$36 billion, coupled with a smaller outflow in the capital and financial account. As a result, the official foreign reserves increased to \$128 billion as at end-1999, equivalent to 8.2 months of current imports¹

GROSS EXTERNAL DEBT

As at end-December 1999, Singapore did not have any external debt.

FISCAL POLICY

Fiscal policy seeks to create an environment that promotes a dynamic private sector, generates robust growth and employment, and advances the development of Singapore. Fiscal policy in 1999 remained geared towards these objectives, in support of sustained, non-inflationary economic growth.

Government expenditures focus on the delivery of essential public goods and services, particularly in the key areas of education, housing, economic infrastructure, basic health care and national security. As in previous years, the bulk of expenditures in 1999 were allocated to social and community services (40 percent) and security (34 percent). Economic services accounted for another 18 percent of total expenditures.

Total government expenditure grew from \$24.8 billion in 1998 to \$24.9 billion in 1999. The slight increase was due to higher development spending (\$11 billion), which rose by 4.6 percent over 1998. However, operating expenditure (\$13.9 billion) declined by 2.3 percent over 1998, partly because of the civil service wage adjustments in line with the policy of wage restraint.

¹ The official foreign reserves also reflect the impact from exchange rate changes, as it is valued at the exchange rate prevailing at the end of the period. This is in contrast to the book cost valuation of the balance of payments.

On the revenue side, the taxation policy in 1999 continued to focus on enhancing our internationally competitive tax structure to encourage corporate and individual entrepreneurship. Supported by the pick-up in economic growth, the government was able to raise sufficient revenue to finance both the operating and development expenditures. Government operating revenue grew by 1.4 percent from \$28.2 billion in 1998 to \$28.6 billion in 1999. The increase was largely due to increases in income tax, fees and charges, and interest received as a result of higher outstanding loans from the government to statutory boards.

Against a more favorable economic backdrop, the budget surplus for fiscal year 1999 (1 April 1999 to 31 Mar 2000) came up to \$2.9 billion, or 1.9 percent of GDP.

MONETARY POLICY

The objective of monetary policy remained one of maintaining price stability for sustained economic growth. In view of the subdued inflationary environment and the need to facilitate the recovery in the economy, the Monetary Authority of Singapore (MAS) adopted a neutral exchange rate policy stance in 1999. In addition, given that currency markets have become less volatile compared with the year before, the MAS also narrowed the exchange rate policy band to its pre-crisis width.

EXCHANGE RATE

The movement of Singapore dollar exchange rate against major industrial and regional currencies was mixed in 1999. Although it depreciated against the US dollar in the first half of the year, the Singapore dollar pulled back in the last two quarters due to the stronger-than-expected domestic economic recovery and renewed interest in the local bourse. Nonetheless, Singapore dollar depreciated by an average 1.3 percent against the US dollar in 1999, after the 11 percent depreciation seen the year before. Underpinned by Japan's improved economic outlook, the Yen had strengthened significantly against major currencies. Thus the Singapore dollar also weakened against it, by 14 percent in 1999 compared to a depreciation of 4.3 percent in 1998.

On the other hand, the Singapore dollar firmed against most European currencies in 1999. It strengthened marginally against the Pound Sterling and the Deutschemark by 1.1 percent and 2.9 percent respectively, in contrast to the double-digit depreciation in 1998. Against the French franc and Italian lira, the Singapore dollar appreciated by 3 percent each. Since its introduction in January 1999, the Euro depreciated by 14 percent against the Singapore dollar.

The Singapore dollar depreciated against most currencies of the ASEAN and NIE countries. With the economic turnaround and the return to relative stability, regional currencies rebounded in 1999, following the sharp depreciation experienced the year before. The Singapore dollar fell by 21 percent against the Indonesian rupiah, 16 percent against the Korean won, 8.9 percent against the Thai Baht, and 4.8 percent against the New Taiwan dollar. Against the Malaysian ringgit, the Singapore dollar depreciated by 4.2 percent compared with an appreciation of 25 percent in 1998. Given the Hong Kong dollar peg to the US dollar, the Singapore dollar also weakened against it by 1.1 percent.

INTEREST RATES

The external interest rate environment was generally tighter in 1999. While the US Federal Reserve had implemented a series of interest rate hikes over the year, the European Central Bank and the Bank of England eased rates in the earlier part of the year before tightening in the later half. Singapore's 3-month interbank interest rate reacted to some of these fluctuations. From 1.75 percent at end-December 1998, the benchmark rate ended the year at a 14-month high of 2.63 percent. However, at 2.03 percent on average, it was lower than the average of 5.18 percent in 1998. It also remained below the 3-month US dollar SIBOR, which was boosted to 6.06 percent at end-December by the three quarter-point hikes in US interest rates in 1999. However, the differential between 3-month US dollar SIBOR and the domestic interbank rate remained largely unchanged at 3.43 percentage points at end-1999 compared with 3.38 percentage points at end-1998.

Retail deposit and lending rates were stable in 1999. The average prime lending rate of the leading banks moderated slightly from 5.90 percent at end-December 1998 to 5.80 percent in January 1999 and remained unchanged throughout the year. The 3-month and the 12-month fixed deposit rates also slid marginally to 1.68 percent and 2.46 percent respectively, before remaining constant from March 1999 to the end of the year.

MONEY SUPPLY

Growth of narrow money (M1) strengthened in 1999 to 14 percent, compared with a contraction of 0.9 percent in 1998. The rapid rise in narrow money was largely due to a 16 percent increase in demand deposits, up from 9.7 percent in 1998. The preference towards holding more readily accessible funds reflected the low interest rate environment and the pick-up in economic activity. Broad monetary aggregates, M2 and M3, also expanded, albeit at slower rates of 8.5 percent and 7.3 percent respectively in 1999, compared with 9.7 percent and 8.1 percent in the previous year. The moderation was due to the halving of the growth of fixed deposits, although savings deposits continued to increase at double-digit rates in 1999.

OUTLOOK FOR THE SINGAPORE ECONOMY

Global economic conditions have returned to normality in 1999, after the upheavals and uncertainties in the previous two years. The continued strong growth in the US, albeit some signs of deceleration in consumer spending, and the firming of the EU economy have been important. In Asia, the gradual recovery of the Japanese economy and better than expected growth performance in China; Hong Kong, China; Korea; and Malaysia also played a major role.

In view of the favorable external environment, the outlook for the Singapore economy is bright. Business expectations from the industry and services providers have also been positive. Going into 2000, the strong global electronics demand and the revival in intra-Asia trade will help reinforce Singapore's economic growth

Taking into consideration the above factors, the official GDP forecast for Singapore for 2000 is 7.5 percent to 8.5 percent.

STRATEGIES AND ADJUSTMENT MEASURES UNDERTAKEN TO SUSTAIN THE RECOVERY AND STRENGTHEN MARKETS

Cost-Cutting Package

With the regional economic storm now passed, comes the challenge to manage the recovery and restore economic growth on a sustained basis. While growth has become broader based and employment is down, the economy still has to address some weaknesses. For example, several manufacturing industries such as disk drives and petroleum refining continue to face severe cost pressures. Continuing restructuring is causing a steady stream of retrenchments.

In light of these developments, the government has reviewed its economic stance, and particularly the measures in November 1998's cost reduction package. In general, the package will continue as committed, but the tightening labor market has made it necessary to bring forward the restoration of employer CPF contribution rates. The improved economic outlook also justifies a higher quantum of year-end bonus for civil servants, and a restoration of the wage cuts imposed on civil servants. The Skills Development Levy has been adjusted, as skills upgrading is critical to keeping workers employable. In key areas of business costs, namely industrial land rentals and port and airport dues, the rebates have been extended for an additional year.

Deregulation of the Services Sector

The recent regional economic turmoil has altered the backdrop for economic growth and cost competitiveness. Singapore needs to undertake appropriate reforms and strategies to remain competitive. One area in which Singapore is still a laggard is the deregulation of services. Compared to the manufacturing sector, the services sector is still very much closed and inefficient. However, the Internet is accelerating the tradability of services, and as a result, the services sector in every country will increasingly be subject to global rather than domestic or regional competition. In addition, given the blurring boundary between goods and services, an efficient and competitive services sector will be a vital factor contributing to the vibrancy of the manufacturing sector. The government therefore stepped up the deregulation of the services sector – in financial services, telecommunications, electricity and gas.

In May 1999, the MAS further unveiled its banking sector liberalization package, which included measures to allow new entrants into the banking industry, improve corporate governance, remove the foreign shareholding limit, and allow for more regulatory flexibility concerning the operations of local banks. The aim is to move towards a more open and competitive environment, so as to spur the development and upgrading of local banks, and develop a more dynamic financial sector.

In February 2000, the Info-Communications Development Authority (IDA) brought forward the introduction of full market competition in the telecommunications sector by two years, starting April 2000. Direct and indirect foreign equity limits for all public telecommunications services licences were also lifted. An earlier liberalization of the telecommunications sector would attract major players and help develop a strong and vibrant info-communications industry, which depends on globally competitive telecommunication rates and services.

As power is a key component of business costs, Singapore has to be globally competitive in this sector. Within the next two years, the contestable parts of the electricity sector will be opened up fully and competition will be introduced in the natural gas industry.

Committee on Singapore's Competitiveness

The Committee on Singapore's Competitiveness (CSC)'s vision is for Singapore to become an advanced, globally competitive, knowledge economy over the next decade, with manufacturing and services as the twin engines of growth.

Manufacturing will remain an integral component in the Singapore economy, but developing capabilities in the whole manufacturing value chain beyond production, from R&D and design to marketing and sales will also be needed. At the same time, Singapore will develop into a premier services hub in Asia with a global orientation, with strong competencies in both our traditional hub services as well as new, high growth services. The domestic sector will be competitive and vibrant, capable of producing world-class companies and internationally competitive industries. The workforce will be cost-competitive with world-class capabilities in business management, technology, innovation, production and services, and international market development.

Singapore will become a knowledge-based economy where the basis for competitiveness will be the capabilities and intellectual capital to absorb process and apply knowledge and to move quickly. Singapore will be an open cosmopolitan society, attractive to global talent and connected with other global nodes. Together with the global talent, a critical mass of risk-taking entrepreneurs, innovators and arbitrageurs will move the economy ahead in the Information Age.

Eight Key Strategies Are Recommended To Support Singapore's Competitiveness Strategies

1. Manufacturing and services as twin engines
To lessen dependence on any single sector or market, thereby reducing vulnerability and providing a broader and more resilient economic base.
2. Strengthening the external wing
To add a complementary source of growth to the domestic economy to help overcome our domestic resource, market and talent constraints.
3. Developing world-class companies
To increase the depth of corporate profile and broaden the economic base for more sustained and resilient growth.
4. Strengthening the base of local enterprises
To realize their maximum potential and to entrench their relevance as important strategic partners to MNCs and GLCs in the long run.

5. Human and intellectual capital as a key competitive force
To develop a world-class workforce, comprising domestic and foreign talent, which is motivated, cost-competitive and with outstanding capabilities.
6. Leveraging on science, technology and innovation as competitive tools
To upgrade existing industry and business clusters and to build core capabilities to position Singapore as a global IT hub in the Asia Pacific.
7. Optimizing resource management
To continually optimize the allocation of scarce resources to support the needs of various industries.
8. Government as business facilitator
To play an active role to support and facilitate the private sector through provision of sound, consistent economic policies and a regulatory environment that is conducive to the conduct of business.

CHINESE TAIPEI

The significant recovery in the international economy fueled the sharp export expansion and economic upturn of Chinese Taipei in 1999. Although the September 21 earthquake moderately slowed the momentum of growth, the economy proved sufficiently resilient and dynamic to quickly shrug off the effects of this major disaster. The gross domestic product growth rate for the year was 5.4 percent. The World Economic Forum ranked Chinese Taipei fourth in the world in “The Global Competitiveness Report,” up from sixth in 1999.

In February 1999, the government launched the “Economic Enhancement Plan”, a mid- and long-term program of reforms for root-and-branch strengthening of the financial system, corporate governance, land and housing measures, and labor related laws. To cope with the aging society and changing family structures, a national pension system is being planned which will integrate current old-age related social insurance and social assistance, so that every person can enjoy basic pension protection.

GROSS DOMESTIC PRODUCT

Real gross domestic product grew by 5.4 percent in 1999, up 0.8 percentage points from 1998. While private investment declined sharply during the year, reviving net foreign demand and a pickup in private consumption contributed to the whole economy’s growth.

On the production side, industrial growth climbed to 4.7 percent in 1999, from 2.7 percent in 1998, with manufacturing sector output up by 6.7 percent. The shares of agriculture, industry, and services in overall domestic production were 2.6 percent, 33.2 percent, and 64.3 percent respectively. The services sector increased its share by 1.3 percentage point from the previous year.

INFLATION

The consumer price index (CPI) rose by a mere 0.2 percent in 1999, the lowest rate of increase since 1986, due mainly to the year-round abundant supply of low-priced vegetables and fruits, and the fall in price of information and communication products. Although raw material prices rose during the year, the wholesale price index (WPI) declined by 4.6 percent as international export prices remained low.

EMPLOYMENT

The overall labor participation rate declined to 57.9 percent, reflecting such long-term contributing factors as more young people enrolling in higher education and the growing trend of earlier retirement, as well as the incomplete state of economic recovery. The unemployment rate stood at 2.92 percent, the highest since 1967. In response to the changes in the labor market, the government launched an unemployment insurance program in January 1999. During the year, the government also implemented a number of programs to assist those who lost their jobs, through factory closures and layoffs, to find new jobs.

TRADE ACCOUNT

Two-way trade has returned to its 1997 pre-Asian Financial Crisis level. In 1999, the value of exports amounted to US\$121.6 billion and imports US\$110.7 billion, up from the previous year's level by 10.0 percent and 5.8 percent, respectively. Exports to Japan and the ASEAN economies recorded double-digit growth. The share of heavy industrial products increased by 3.2 percentage points to 67.5 per cent, due mainly to the accelerating international labor division in the IT industry and the replacement of information equipment for Y2K compliance.

With the trade surplus sharply increasing, the current account surplus went up to US\$10.9 billion. The capital account posted a net outflow of US\$0.17 billion, largely due to the increase in emigration remittance. The financial account recorded a net inflow of US\$13.0 billion, with foreign investment in the local securities market reaching a record high of US\$13.9 billion in the year.

GROSS EXTERNAL DEBT

Gross external public debt, defined as debt repayable to external creditors by the public sector with an original or extended maturity of more than one year, reached a peak of US\$6,290 million at the end of 1983. Since then, it has continued to decline, decreasing to US\$29.5 million by the end of 1999 from US\$46.4 million at the end of 1998.

EXCHANGE RATE

Since the late 1980s, a floating exchange rate regime has been in operation. Only on a few occasions, where strong irrational expectations were in place, has the central bank intervened in the market.

In 1999, the NT\$/US\$ exchange rate remained relatively stable prior to the Chinese New Year. After the holiday, the NT dollar fell against the US currency, hitting its lowest level for the year on February 20 at 33.257. This was due to the sharp depreciation of the Japanese yen against the US dollar when the Bank of Japan sought to ease the credit crunch by lowering the overnight call-loan rate to near zero. From the second quarter, the sharp increase in Chinese Taipei's exports and the net capital inflow caused expectations of NT dollar appreciation. The NT\$/US\$ exchange rate moved consistently in an upward trend, to reach 31.395 at year-end. Between February 20 and December 30, it appreciated by 6.27 percent. If a comparison is made based on the trade-weighted average exchange rate involving fifteen major trading partners, the NT dollar appreciated by 0.94 percent in 1999.

FISCAL POLICY

Central government expenditure grew from NT\$1,260.0 billion in FY1998 to NT\$1,430.9 billion in FY1999, an increase of 13.6 percent. Meanwhile, central government revenue increased from NT\$1,263.1 billion in FY1998 to NT\$1,357.3 billion in FY1999, an increase of 7.4 percent. To bridge the gap between revenue and expenditure, the government had to deplete surpluses from previous years and to issue new bonds.

In 1999, the most significant fiscal policy adopted was the implementation of the Domestic Demand Stimulus Package, launched by the government in August 1998, which allocated an additional budget of NT\$63.7 billion for public investment. As a result, the real public investment growth rate for 1999 reached 7.7 percent, the highest in seven years, which contributed 0.64 percentage point to the economic growth rate.

MONETARY POLICY

As price movements remained stable in the year, the Central Bank continued to adopt a moderately easy monetary policy, which it had followed since August 1998. The Central Bank lowered the rediscount rate and cut required reserve ratios in February 1999, which was the fourth and third time, respectively, since September 1998. In addition, the Central Bank appropriated NT\$250 billion from postal savings re-deposits to assist business, homebuyers, and repair and rebuilding of quake-damaged homes. In 1999, M_2 grew at an annual rate of 8.3 percent, which was within the 6 to 11 percent target range set for the year. The average overnight inter-bank call-loan rate in 1999 was 4.8 percent, lower than the 6.6 percent of the previous year.

Real interest rates, computed by subtracting CPI inflation rates from one-year time deposit rates, have been on a downward trend since 1990. The average of real interest rates quoted by five leading banks in July 2000 was 3.47 percent, below the 3.76 percent recorded at the end of 1998. As for nominal interest rates, both long- and short-term rates have fallen considerably since February 1998.

MEDIUM TERM OUTLOOK

Both external and internal demands are expected to strengthen in 2000. As the effects of the Asian Financial Crisis continue to recede, and the local electronic industries continue to gain competitiveness in the world market, the strong growth of exports should be sustained. Domestic demand will be boosted by a number of factors, including the overall strength of the economy, the gathering impetus of post-quake reconstruction, implementation of the high-speed railway project, and further streamlining of production in the IC industry.

In the first half of 2000, Chinese Taipei's real GDP increased by 6.7 percent, as compared to the same period in the previous year, with exports, private investment and industrial production having seen noticeable growth, in spite of some volatility in the financial sector. Prices remained stable, with wholesale prices and consumer prices increasing by 1.5 percent and 1.1 percent, respectively, during the period.

Exports and imports increased by 23.2 percent and 32.8 percent, respectively, in the first six months of 2000, resulting in a sharp reduction in the trade surplus. Private/business sector investment increased by 22.8 percent, and industrial production expanded by 6.5 percent in the same period, both in real terms.

The current industrial policy is focused jointly on steps to revitalize traditional industries and on promoting Chinese Taipei as a knowledge-based economy. With the aim of

creating a Green Silicon Island, industrial productivity and national competitiveness will be enhanced together with the strictest emphasis on environmental protection.

The official projections for Chinese Taipei in 2000 are as follows:

Economic growth: 6.6 percent.

Annual increase in consumer prices: 1.6 percent

Growth in real exports and imports: 18.2 percent and 17.2 percent, respectively.

THAILAND

REAL GROSS DOMESTIC PRODUCT

After an unprecedented real gross domestic product (GDP) contraction of 10.2 percent in 1998, the economy began showing positive signs of recovery in the beginning of 1999. Real GDP growth in 1999 was 4.2 percent, led by the manufacturing sector and increased domestic demand boosted through several government stimulus packages. The capacity utilization rate in the manufacturing sector increased to 63 percent from slightly more than 50 percent in 1998. While this was still below normal levels of 70 to 80 percent, manufacturing was nevertheless the engine of economic recovery, with a growth rate of around 11.3 percent in 1999.

Vehicle and transportation equipment production showed the highest rate of growth. New vehicle models boosted domestic demand, and exports expanded as foreign vehicle producers used Thailand as a production center for regional manufacturing. Agriculture showed modest growth of 0.5 percent, with increased production of major crops such as rice, rubber, maize, and cassava partly offset by a sharp decline in farm prices. Domestic demand, which had contracted sharply the previous year, picked up, particularly in the second and third quarters of 1999, and rose to 8.5 percent for the year. Private consumption grew moderately, resulting in part from rising consumer confidence, and modestly expanding farm income. Government stimulus measures, which included reducing the value-added tax rate from 10 to 7 percent and cutting taxes on petroleum products, also helped boost private consumption.

Tourism continued to grow, with the number of tourists reaching 8.5 million in 1999, a 10.1 percent increase from the previous year. The private/business sector investment index declined moderately in 1999, compared with a steep decline in 1998.

INFLATION

Following a year of relatively high inflation of 8.1 percent in 1998, the price level was remarkably stable in 1999. Despite upward pressure from rising oil prices in the world market, inflation was contained at 0.3 percent, the lowest level recorded since Thailand started compiling the index more than 50 years ago. The exchange rate and most commodity prices (aside from oil) remained stable, while domestic demand recovery did not generate upward pressure on prices.

EMPLOYMENT

The economic crisis has resulted in historically high unemployment since mid-1997. The unemployment rate before the crisis was around 1.51 percent. By 1998, this figure had almost tripled to 4.37 percent of the total labor force, and underemployment had increased significantly. The situation eased somewhat in 1999, as the unemployment rate declined slightly to 4.17 percent. Public programs boosted temporary employment, and the agriculture sector absorbed a significant number of laid-off urban workers who had returned to their provinces. Furthermore, both output and employment growth remain below pre-crisis growth rates, after falling sharply in 1998.

TRADE ACCOUNTS

While trade and current account surpluses fell slightly in 1999, external sector performance nevertheless improved significantly as export earnings in dollar terms increased by 7.4 percent. Import growth was higher at 17.7 percent, resulting in a decline in the trade surplus from 10.8 percent of GDP in 1998 to 7.4 percent in 1999. The current account surplus fell from 13.3 percent of GDP in 1998 to 9.1 percent in 1999. Meanwhile, despite increased inflows of foreign direct investments, net capital movements registered a deficit of US\$6.1 billion, reflecting large private capital outflows as commercial banks continued to repay their external debts, in particular Bangkok International Banking Facility offshore loans. (This organization, established in 1993, allows licensed banks to operate offshore, borrow abroad, and lend to domestic borrowers in foreign currencies.)

GROSS EXTERNAL DEBT

In December 1999, external debt stood at US\$95.6 billion, down from US\$105.1 billion at the end of 1998; the share of short-term debt also declined from 27 percent to 21 percent of total external debt during the same period. However, public sector debt as a proportion of total external debt has almost tripled since the crisis began in July 1997, and accounted for 38 percent of total debt. Official international reserves increased to a comfortable level of US\$34.8 billion (approximately 9 months of import equivalent) in December 1999. This was remarkable because international reserves essentially had been depleted by December 1997. The high level of reserves prompted the government to suspend disbursement of the US\$3.5 billion installment due for disbursement under the US\$17.2 billion International Monetary Fund package of August 1997. The exchange rate remained stable at around 37-39 baht per US\$ in 1999.

To sum up, with the exception of private investment and commercial bank credits, indications of recovery are growing. Private consumption and manufacturing production picked up in particular in the second and third quarter of 1999, and the performance of the external sector steadily improved.

EXCHANGE RATE

At the onset of the crisis, the Baht depreciated substantially to 53.7 baht per US\$ in January 1998. With sound stabilization measures including various structural reform measures undertaken by the government, the baht has become stable and less volatile. The appreciation of the baht was helped by a steady gain in international reserves, a decline in short-term foreign debt, as well as the stability in the regional currencies markets. By the end of 1999, the exchange rate was 37.84 baht per US\$, about 49 percent lower than its pre-crisis level of 25.34 baht per US\$ at the end of 1996.

FISCAL POLICY

In 1999, the government maintained the expansionary fiscal stance adopted in 1998, after the fiscal and monetary targets of the adjustment program of 1997 and early 1998 plunged the economy into a deep recession. The government continued to relax its public sector deficit target. Under the Eighth Letter of Intent to the International Monetary Fund in September 1999, the consolidated deficit – including the cost of financial restructuring, estimated at 1.7 percent of GDP – was projected at 7.2 percent of GDP for 1999,

compared with 5.5 percent the previous year. During 1999, the government launched two economic stimulus packages, along with tax and tariff reductions. The March 1999 package was aimed at stimulating domestic demand, providing liquidity for key sectors such as exports and agriculture, and providing a social safety net to minimize the impact of the crisis on the poor. The second fiscal package, introduced in August 1999, was aimed at stimulating sluggish private investment and included tax measures, equity investment measures, measures to promote recovery of the real estate sector, and measures to restructure financial facilities for small and medium-sized enterprises (SMEs).

MONETARY POLICY

Despite an easing of monetary policy, the growth rate of money supply continued to slow in 1999, in line with the decrease in commercial bank credits and deposits. At the end of 1999, the increase in money supply (M2) and M2A (including finance and securities companies) was 2.1 percent and 1.3 percent, respectively, compared with 9.5 percent and 6.1 percent at the end of the previous year. With high liquidity in the money market, interest rates dropped to very low levels, with the interbank rate at 1.23 percent, prime rate at 8.25 – 8.50 percent, and deposit rates at 4.00 – 4.25 percent in December 1999. However, the credit crunch continued because of the banks' concern with existing levels of non-performing loans (NPLs), and tightened loan-loss provisioning and capital adequacy requirements. Credit extension by commercial banks posted negative growth throughout; the total amount of NPLs in this financial sector was 2,074 billion baht, or 38.5 percent of total loans outstanding in December 1999.

MEDIUM-TERM OUTLOOK

The economy is expected to build on its 1999 performance, growing at a slightly higher rate in 2000 and 2001, but not to return to pre-crisis growth levels. Capacity utilization in the manufacturing sector should reach normal levels of around 70 percent in the first half of 2000, which should be reflected by a return to positive private/business sector investment levels.

While the recovery in 1999 was primarily export-driven with additional support from public stimulus measures and tourism, domestic consumption must rise if GDP growth is to continue in 2000 – 2001. In the financial sector, the transfer of bad bank loans to newly established Asset Management Companies (AMCs) is expected to reduce the level of NPLs held by commercial banks by 2001. However, if these plans are derailed, banks are unlikely to undertake the required volume of new lending to fund a sustained recovery in production and economic growth. As demand catches up and capacity utilization rises, inflation in 2000 is forecast at about 2.5 to 3 percent.

Implementation of the August 1999 fiscal package, along with continued financial restructuring, will keep the consolidated deficit at 6 to 7 percent of GDP in 2000. If the growth rate of trade continues, the trade surplus will continue to shrink to about 4 percent of GDP in 2000. This will also translate into a decline in the current account surplus to about 5 to 6 percent of GDP. Gross official reserves are expected to be maintained at the same level in 1999, and external debt and the debt-service ratio are expected to decline further.

UNITED STATES OF AMERICA

The United States enjoyed continued strong growth with low and stable inflation in 1999, extending the current expansion while continuing to build up the budget surplus.

GDP GROWTH RATE

Real gross domestic product (GDP) grew 4.2 percent from 1998 to 1999, marking the 8th consecutive year of positive output growth. Strong growth continued in the first quarter of 2000 as real GDP grew 4.8 percent at an annual rate.

Real personal consumption expenditures grew a robust 5.3 percent in 1999, exceeding 1998's 4.9 percent growth rate, and accounted for over 80 percent of real GDP growth. Favorable economic performance helped fuel strong household spending. Real disposable personal income grew 4 percent and the stock market continued to soar, with the Wilshire 5000 ending the year up 22 percent, and measures of consumer confidence reached all-time highs. Stocks were somewhat volatile over the first four months of 2000; nevertheless, consumer confidence remained high and real household spending grew a robust 7.6 percent at an annual rate in the first quarter of 2000.

Real investment grew 5.8 percent in 1999, down from the double-digit growth rates recorded in 1997 and 1998. Real business fixed investment grew 8.3 percent over the year, fueled by large increases in spending on computers and other information processing equipment, while spending on business structures fell. Real residential investment surged 7.4 percent in 1999, in part reflecting relatively low mortgage rates as well as rising wealth. Residential investment continued its strong growth over the first quarter of 2000, but forward-looking indicators suggest a slowdown in the coming months.

Real net exports exerted a drag on GDP growth in 1999 for the fourth year in a row. Real exports began to pick up in the second half of 1999 as foreign economies began to rebound and rose 3.8 percent for the year. But to satisfy growing domestic demand, real imports grew even faster at 11.7 percent.

INFLATION

Broad price measures showed a slight pick-up in inflation in 1999 from the very low pace in 1998. The chain-weighted price indexes for GDP and PCE increased 1.4 percent and 1.6 percent respectively on a year-over-year basis, both up slightly from their year-earlier rates. The consumer price index (CPI) rose 2.2 percent in 1999, up from 1.6 percent in 1998, but dramatic increases in energy prices accounted for all of this acceleration. Core measures of inflation, which exclude volatile food and energy prices, were even more subdued. Core PCE inflation was 1.4 percent on a year-over-year basis in 1999, up only 0.1 percentage point from 1998, while the core consumer price index actually showed a slow-down in the rate of inflation, increasing 2.2 percent in 1999, 0.2 percentage point less than its year-earlier rate.

EMPLOYMENT

The high-pressure U.S. labor market continued its strong performance in 1999 as nearly 2.5 million private non-farm jobs were created. Federal government payrolls fell for the seventh straight year. The service sector added 1.4 million new jobs in 1999, an increase of nearly 4 percent. In contrast, employment in the manufacturing sector, which was particularly hard hit by weak export demand, fell for the second straight year.

The annual unemployment rate dipped to 4.2 percent, its lowest level since 1969. These labor market gains were widely shared as Hispanic and African-American unemployment rates both dropped to historic lows.

The participation rate – the percentage of the population over age 16 that is either employed or looking for work – remained at its all-time high of 67.1 percent for the third straight year.

Strong productivity growth in 1999 helped to keep wage inflation in check despite the very low unemployment rate. Unit labor costs increased only 1.7 percent on a year-over-year basis in 1999. Meanwhile, output per hour in the non-farm business sector rose 3 percent and helped to support real wage gains of 3.7 percent.

TRADE ACCOUNTS

The current account deficit grew to \$339 billion in 1999, or 3.7 percent of GDP. The balance on goods and services was \$268 billion, as a merchandise trade deficit of \$347 billion was partially offset by a services surplus of \$80 billion.

EXCHANGE RATE

The US dollar held fairly steady in real terms against a broad trade-weighted worldwide average of other currencies in 1999. The exchange rate rose slightly over the first quarter of 1999 before retracing its steps over the last few months of the year. In the first four months of 2000, the dollar strengthened steadily, bringing the exchange rate up to levels not seen since mid-1998.

FOREIGN DIRECT INVESTMENT

In 1999, U.S. direct investment abroad was \$152 billion while foreign direct investment into the United States was \$283 billion.

FISCAL POLICY

The Federal Government ran a surplus (on a unified budget basis) for fiscal year 1999 of \$124 billion, compared with \$69 billion in 1998. This marked the first time in over 40 years that the Federal Government has recorded two consecutive budget surpluses. At 1.4 percent of GDP in 1999, the fiscal surplus was the largest relative to the size of the economy in nearly 50 years.

MONETARY POLICY

Amid concern over the potential buildup of inflationary imbalances, the Federal Reserve raised the target Federal funds rate by 75 basis points in three steps over 1999, fully reversing the rate cuts it had instituted in 1998 during the global financial crisis. Over the first six months of 2000, the Fed raised rates three times, stating that the near-term risks are weighted mainly toward conditions that may generate heightened inflation.

MEDIUM TERM OUTLOOK

The economy's remarkable performance has continued into the new millennium. As of June, this business cycle expansion has lasted 111 months. The small increase in inflation this year was largely due to the surge in world oil prices.

As of late July 2000, the consensus of private forecasters now expects growth to slow to 3.5 percent annual rate in the final three quarters of 2000. If this business/private sector consensus comes to pass, the growth rate for the year as a whole will be 4.8 percent, the same as the Administration's projection in its Mid-Session review. The private-sector consensus expects GDP to decelerate to 3.3 percent annual rate of growth for 2001 as a whole. The Administration expects a similar deceleration, to 3.2 percent.

Both supply- and demand-side considerations argue for some moderation in real GDP growth from its rapid 4.4 percent annual pace of the past twelve quarters. The unemployment rate has fallen about 0.4 percentage point per year over this period, indicating that this growth rates is well above its potential. The labor market is very tight as indicated by low unemployment in June and increases in real wages. It is doubtful whether a further decline of the unemployment rate could be accommodated without inflationary consequences. Labor force growth has not kept up with demand in the past two years, nor can it be expected to keep up with growth at such a pace in the future. Finally, some components of demand that contributed to the rapid growth of the past few years, such as business demand for capital goods, are not those likely to be sustainable over the long run.

The U.S. Administration projects U.S. long run GDP growth at about 3.0 percent per year through 2006. This rate is consistent with growth for the 1990 business cycle as a whole and with labor force growth of approximately 1 percent and labor productivity growth of approximately 2 percent.

STRUCTURAL REFORMS

In 1999, the passage of the Gramm-Leach-Bliley Act (GLB) markedly changed the way in which financial institutions meet the needs of the American people. This act updates the rules that have governed financial institutions since the great depression and relaxes prohibitions on affiliations among banks, security firms and insurance companies. By allowing banks to merge with other financial institutions, GLB aims to stimulate competition, increase consumer choice and reduce costs for consumers, communities and businesses. The act also provides protection of consumer privacy and encourages banks to meet the credit needs of under-served communities.

VIET NAM

The Vietnamese economy has made significant progress during the implementation of “The Strategy on Stabilization and Socioeconomic Development up to the Year 2000”. The economy grew by an annual average of 8 percent from 1991 to 1998. Inflation declined from 67 percent in 1990 to less than 10 percent in 1998 and declined further to 0.1 percent in 1999.

The economy’s growth momentum, however, slowed down in 1999 with gross domestic product (GDP) registering a less than 5 percent increase. A more favorable economic situation is foreseen as GDP grew by more than 6 percent in the first half of 2000. The 2000 inflation rate is seen to reach nearly 0-1 percent.

GROSS DOMESTIC PRODUCT

In 1999, GDP grew by 4.8 percent, the lowest increase in the last decade. From 1991 to 1998, GDP grew by an annual average of 8 percent. The economy’s growth, however, has been declining in recent years: 9.5 percent in 1995, 9.3 percent in 1996, 8.2 percent in 1997, 5.8 percent in 1998 and 4.8 percent in 1999.

Agriculture, which employs two-thirds of the labor force and contributes 25 percent of GDP, is one of the major sources of growth. Agriculture’s value-added increased by 5.2 percent in 1999, higher than the 4.3 percent and 3.5 percent growth recorded in 1997 and 1998, respectively. Food production reached 34.3 million tons in 1999, up by 2.5 million tons from the 1998 production level. Rice exports amounted to about 4.5 million tons in 1999.

The industry and construction sector, which accounts for one-third of GDP, faced difficulties due to low efficiency and competitiveness. Industrial gross output increased by 10.4 percent in 1999, with output by the public sector increasing by 12.5 percent and that by the private/business sector by 18.8 percent. Output from foreign-direct investment projects, which account for one third of total industrial production, grew by 6.1 percent in 1999.

The services sector exhibited continuing declines in growth rates in the last two years due to the influence of factor prices. Retail sales value of goods and services of the domestic sector in 1999 reached VND194, 500 billion, an increase of 5.1 percent in real terms.

For the first half of 2000, GDP has grown by 6.2 percent with industry growing by more than 14 percent; international trade by 27 percent, and transportation by 10 percent.

In view of the low competitiveness and low foreign direct investments (FDI), Viet Nam’s National Assembly recently approved a new revised law on FDI while the government has made equitization policies for state-owned enterprises. On 1 July, the country opened its first center for securities transactions.

INFLATION

Inflation, as expressed by the domestic consumer price index, slowed down to 0.1 percent in 1999 and -0.5 percent in the first half of 2000.

POPULATION, LABOR FORCE, AND EMPLOYMENT

During the last ten years, Viet Nam has been highly successful in keeping the population growth rate to a minimum, with the average annual growth rate at only 1.7 percent. The projected population growth rate in 2000 is at 1.53 percent.

Poverty by food security standards now only affects 10 to 11 percent of the population and is projected to go down to 5 percent by 2005.

The number of urban unemployed and rural underemployed have increased due to reduced production and number of businesses. Furthermore, more than one million youths entered the labor force in 1999.

By the latest survey, the unemployment rate in the urban area in 1999 is 7.4 percent, while rural unemployment, evaluated through time-use rate, is about 70 percent.

TRADE ACCOUNT

Exports in 1999 reached almost \$11.5 billion, a 23.1 percent increase compared to 1998. Export value in the first half of 2000 amounted to US\$6.427 billion, a 26.2 percent increase. Meanwhile, exports from the FDI sector increased by 56.8 percent due to the hike in export prices of crude oil (85 percent), higher export volumes for garments, textiles, shoes and electronics. Export prices for coal, rice and coffee, however, were on a downward trend. Imports in the first half of 2000 reached US\$7.154 billion, a 33.8 percent increase compared with the previous year.

Exports for the year 2000 are estimated to reach US\$13.5 billion while, imports are expected to reach US\$14.5 billion, leaving a negative trade balance of US\$1 billion.

EXTERNAL INVESTMENT

By the end of 1999, Viet Nam had issued licenses to more than 2,500 FDI projects with a total capital of \$35 billion, and disbursements of more than \$15 billion. This has significantly contributed to the efficiency and competitiveness of the economy. At present, FDI projects produce about 12 percent of GDP and 35 percent of domestic industrial production output.

Foreign direct investment inflows in the first half of 2000 fell 35 percent to US\$520 million against the same period last year. In the year 2000, the National Assembly approved a revised Law on Foreign Direct Investment, with amendments on: foreign currency, taxes and import duty, land-use rights and mortgage of land-use rights, management of joint venture companies, and approvals and licensing. Moreover, on 20 July 2000, the first Securities Trading Center in Ho Chi Minh City was opened.

Through various conferences, multilateral donors have committed to assist Viet Nam through a US\$15 billion-package, of which the three largest donors, Japan, the World Bank and the Asian Development Bank, account for 70 percent of the total committed capital. Meanwhile, official development assistance (ODA) disbursement has improved, reaching US\$6 billion though still slower than planned. These ODA projects focused on improvement of the legal framework, human resource training, improvement of economic and social infrastructure and the promotion of development of economic sectors.

EXCHANGE RATE

With the devaluation of regional currencies from 30 to 80 percent since 1997, the government has continued to implement foreign exchange controls, export and-import controls and control of commercial credit for imports, in order to avoid debt shocks. The government also controlled foreign borrowings, including government and private borrowings, as these affect the debt service capacity of the country.

As a result of negotiations with the Paris Club and the London Club and strict control of borrowings and debt services, the total debt is estimated to reach about US\$10 billion (excluding Russian debt in transferable rubles, which are under negotiations).

POLICIES

Facing continuous decline in economic growth, the government issued a series of new policies in order to mobilize internal and foreign resources effectively. They aim to:

- Focus on agricultural and rural development, where 76 percent of the population lives and one-third of GDP is produced, and at the same time to favorably facilitate all economic sectors to invest into production and business development;
- Expand markets by promoting domestic demand and improving exports' efficiency and to create to new markets;
- Address urgent needs in financial, monetary, and banking sectors in order to improve the effectiveness of the banking activities;
- Reorganize and renovate the SOEs targets: reduction of total SOEs by 3000 units in the year 2003 and by 2000 units in the year 2005;
- Implement poverty alleviation programs particularly job generation; and
- Continue to implement administrative reform and to improve capacity in governance and execution.

OUTLOOK

Economic growth in 2000 is expected to be from 6 to 6.5 percent, and to be 7 percent for 2001-2005, of which:

	2000	2001–2005
GDP	6–7 percent	7 percent
Agriculture	3.5–4 percent	3.5 percent
Industry and construction	9–9.5 percent	9.5 percent
Service	4–5.5 percent	6 percent
Industrial output	14.5 percent	12 percent
Agricultural output	4–4.5 percent	4 percent

The regional economic recovery is expected to be slow and complicated. Viet Nam has to contend with fierce competition in the international and regional markets. While some of Viet Nam's export products such as crude oil fetched high export prices, the export price of rice and other agricultural commodities continue to decline. Further, some products cannot compete with their foreign counterparts. The prices of some of the locally produced commodities in Viet Nam are twice as much as their imported counterparts. However, as part of its commitment under the ASEAN Free Trade Area, Viet Nam has to reduce its tariffs to between 0 and 5 percent by 2006.