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Global Economic Prospects

and the Developing Countries

1996

A N K B O O K

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Contents

Abbreviations and data notes

APEC	Asia-Pacific Economic Cooperation	GSP	Generalized System of Preferences
ASEAN	Association of South East Asian Nations	IMF	International Monetary Fund
CFA	Communauté financière africaine	LIBOR	London interbank offer rate
CPI	Consumer price index	Mercosur	Latin America Southern Cone trade bloc
EC	European Community		(Argentina, Brazil, Paraguay, Uruguay)
EU	European Union (formerly the EC)	MFA	Multifiber Arrangement
FDI	Foreign direct investment	MUV	Manufactures unit value (index)
G-3	Germany, Japan, and the United States	NAFTA	North American Free Trade Agreement
G-5	France, Germany, Japan, United Kingdom, and United States	NIES	Newly industrialized economies
		OECD	Organization for Economic Cooperation and Development
G-7	Canada, France, Germany, Italy, Japan, United Kingdom, and United States	OPEC	Organization of Petroleum Exporting Countries
GATT	General Agreement on Tariffs and Trade	PPP	Purchasing power parity
GDP	Gross domestic product	WTO	World Trade Organization

Data notes

The Classification of Economies tables at the end of this volume classify economies by income, region, export category, and indebtedness. Unless otherwise indicated, the term "developing countries" as used in this report covers all low- and middle-income countries, including the transition economies.

The following norms are used throughout:
- Billion is 1,000 million.
- All dollar figures are U.S. dollars.
- In general, data for periods through 1994 are actual, data for 1995 are estimated, and data for 1996 onward are projected.

Foreword

Global Economic Prospects and the Developing Countries is an annual report prepared by the staff of the World Bank's International Economics Department. The series, now in its sixth year, provides an annual assessment of global economic prospects as they affect developing countries and analyzes the links between developing countries and the world economy, particularly in the areas of trade, foreign direct investment and other capital flows, and commodity markets.

Last year's report focused on the increasing integration of developing countries with the global economy, highlighting the opportunities and challenges that arise from such integration. This year's report starts from the observation that the participation of developing countries in the accelerated pace of integration over the past decade has been marked by large disparities. While some developing countries have rapidly expanded their engagements in world trade and capital markets, many others have not. Some have even become less integrated with the global economy.

Integration matters because there is an association between growth performance and integration. Fast growth tends to promote a more open economy because of policies common to both, and hence lagging integration is a sign of underlying policy deficiencies. Additionally, integration can be a means to higher growth through the channels of better resource allocation, greater competition, transfer of technology, and access to foreign savings. Many of the countries that are lagging in global integration are among the poorest.

Developing countries that have lagged behind in opening to world trade are often deterred by perceptions of trade barriers. But some of these fears are exaggerated. For example, tariffs are lower now than at any time in the postwar era. Neither does being a commodity exporter preclude improvements in productivity and diversification: many commodity exporting countries have been among the high-growth, fast integrators.

Concerted action on the part of the international community also is needed to remove some of the real obstacles to trade liberalization that are external; for example, the spread of antidumping practices, agricultural protection, and, for the time being, the Multifiber Arrangement. It is important to ensure continuing efforts to open international markets in these areas.

Globalization and its impact on developing countries raise a number of policy and research issues that we are now beginning to understand more clearly. This report represents part of the ongoing work of the International Economics Department to address these issues.

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Summary

The pace of global economic integration—the widening and intensifying of international linkages in trade and finance—has accelerated over the past decade. During 1985–94 the ratio of world trade to GDP rose three times faster than in the preceding ten years and nearly twice as fast as in the 1960s, the celebrated "golden age" of rapid world growth and trade expansion. Over the same period foreign direct investment doubled as a share of global GDP, while the share going to developing countries rose to more than a third.

The pace of integration among developing countries has been very uneven, however. Though in the aggregate developing countries kept pace with the world rate of trade integration, the ratio of trade to GDP *fell* in forty-four of ninety-three developing countries in the past ten years. The distribution of foreign direct investment was also skewed: eight developing countries accounted for two-thirds of foreign direct inflows in 1990–93, while half of all developing countries received little or none.

As argued in last year's *Global Economic Prospects*, globalization is underpinned by liberalization of economic policies and by technological advances that continue to facilitate transport and communications networks. Increased participation in the world economy carries important benefits: improved resource allocation, heightened competition as a spur to achieving world standards of efficiency, wider options for consumers, the ability to tap international capital markets, and exposure to new ideas, technologies, and products. But globalization also demands more of governments. As firms in developing countries face more intense international competition their needs for clear rules, a stable environment, access to imports, efficient infrastructure, and freedom from red tape increases. And greater reliance on private sources of finance makes it essential to retain the confidence of international capital markets.

Not all countries have risen to the challenges of globalization, and this year's report focuses on developing countries that are lagging in integration. The causes and implications of lagging integration and the policies that countries can adopt to become more productive participants in the world economy are the main themes of this year's report:

- A review of prospects for the world economy suggests that the next ten years will likely see an acceleration in the pace of international integration—even compared with the rapid pace of the past ten years. Real interest rates will be moderate, and growth of world trade is likely to exceed 6 percent a year in volume terms, faster than at any time since the 1960s. The international economic environment is not devoid of risks, but it appears to have become more stable, and this will help developing countries that have embarked on outward-oriented reforms. In the aggregate, then, the growth of developing countries is likely to accelerate. Still, if current policies continue, large differences in performance among developing countries will persist. Countries with bad policies will tend to lag in integration and are likely to see only a mild rise in per capita incomes, with the income gap favoring strong integrators continuing to widen.
- Disparities in the level and speed of integration, as measured by such indicators as ratios of trade and foreign direct investment to GDP, are closely associated with differences in growth rates. The quarter of developing countries that integrated most quickly over the past decade grew nearly 3 percentage points faster than the slowest integrating quarter. Many low-income countries are among the least integrated, and some became even more marginalized during this period. But other low-income countries—including some of the largest—were among the fastest integrators. The quality of policies is critical to the speed of both integration and growth, and there also appears to be a mutually reinforcing relationship between the two. Policy reforms designed to increase an economy's growth and stability are likely to influence a country's speed of inte-

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gration both directly and through their effect on growth. Examples include policies that ensure macroeconomic stability and realistic exchange rates, and investments in telecommunications and transport infrastructure.

The report also addresses two questions often asked by policymakers in countries that aim to promote growth by opening to the global economy:

- Will trade liberalization work? Though some important external obstacles remain on the path to increased exports from developing countries—such as the proliferation of antidumping initiations—trade barriers facing developing countries are lower now than at any time in postwar history. They are much lower now, for example, than during the 1960s, when countries in East Asia began penetrating world markets. In fact, internal obstacles to export growth, such as excessive transport costs, are sometimes as important as external ones. And while there are genuine transition costs to trade liberalization, experience shows that they can be managed. Trading arrangements between developing and industrial countries, one avenue of liberalization, can bring important benefits to developing countries, securing markets, encouraging investment, and enhancing the credibility of reforms by establishing precise timetables. But such arrangements are not a panacea, and they require the speedy adoption of complementary policies that enhance economic stability and flexibility.

- How can commodity-reliant countries enhance productivity and diversify exports? Many slow-growing, lagging integrators rely on primary commodities for exports, but so do (or did) many countries that are now fast-growing, strong integrators. In fact, successful commodity-reliant countries outperformed manufactures-exporting developing countries in terms of both growth and integration over the past ten years. The successful countries followed policies that enhanced their ability to invest and compete in international markets in primary commodities, and not just in manufactures, notably by strengthening the private sector, encouraging foreign direct investment, promoting the application of research and technology, and developing physical infrastructure.

In summary, the experience of fast-integrating developing countries provides many powerful, practical lessons in how countries can expand their engagement with the world economy in order to enhance growth. Countries that are lagging in integration will likely face a favorable external environment in which to undertake reforms, and these reforms have a large role to play in furthering growth. For the lagging countries, managing the transition toward increased integration will be a difficult but crucial challenge.

Long-run prospects for the growth
and integration of developing countries

Despite recessions and modest growth in industrial countries the global economic environment for developing countries was relatively favorable over the past five years. World trade growth averaged 6.1 percent a year in 1991–95, more than 4 percentage points higher than the growth of world output. Private capital flows to developing countries quadrupled. Inflation in the OECD countries (as measured by the consumer price index) remained under 3 percent, real short-term interest rates in the Group of Seven (G-7) countries averaged under 2 percent, and real non-oil commodity prices stabilized (and even rose) after a decade of decline.

Yet marked disparities in growth persisted among and within developing regions. The extent to which countries benefited from the increased integration of world goods and capital markets was also highly uneven (table 1-1). The fastest-growing regions over the past five years—East and South Asia, Latin America—also showed the largest advances in integration with the world economy, as measured by the size of capital inflows and the growth of exports. Sub-

Saharan Africa and the Middle East and North Africa, on the other hand, grew the slowest and advanced their integration the least. Experience in Europe and Central Asia, where most countries are in transition toward a market economy, was mixed. Many of these countries accomplished a remarkable reorientation of exports toward Western (primarily European) markets and attracted significant capital inflows. The high-income countries, which typically are the most integrated with world markets, achieved per capita annual income growth of 1.2 percent, faster than most developing countries.

Last year's *Global Economic Prospects* (World Bank 1995b) argued that globalization—the increased integration of world markets for goods, services, and capital—would affect the growth prospects of developing countries by expanding opportunities and intensifying competition in international markets. Globalization, consequently, places a high premium on sound policies. This year's report focuses on the large number of developing countries that are lagging behind. The causes and implications of lagging inte-

Better-integrated economies tend to achieve higher growth

Table 1-1 Growth and integration, 1991–95
(percent)

Region	Real GDP growth per capita, 1991–95	Export growth per capita, 1991–95	FDI inflows as a share of GDP, 1993–95	Other private capital flows as a share of GDP, 1993–95
East Asia	8.0	14.1	3.1	2.5
South Asia	2.2	8.4	0.3	1.2
High-income countries	1.2	5.0	0.6	0.4
Latin America and the Caribbean	1.1	7.2	1.1	2.0
Middle East and North Africa	–0.2	0.4	0.4	0.3
Sub-Saharan Africa	–1.5	–1.6	0.9	0.1
Europe and Central Asia	–7.7	1.0	1.4	2.1

Source: World Bank data and staff estimates.

gration and the policies that countries can adopt to become fuller participants in the world economy are the main themes of this year's report.

The rapid pace of world trade growth for a second successive year in 1995 underscores some important implications of globalization for policies in developing countries. Globalization of production processes increases the need for fast, efficient, and reliable communications and transport infrastructure in developing countries. Just-in-time management of input inventories requires a leaner regulatory framework, including faster customs clearance procedures. A significant share of world trade is intrafirm and is stimulated by foreign direct investment as firms seek to reduce production costs and tap unexploited domestic markets.

Thus, to be fully effective, measures that liberalize trade need to be accompanied by complementary policies on foreign direct investment. The importance of foreign direct investment as a vehicle for integration is reflected by the fact that multinational corporations sell more goods through foreign subsidiaries than they export from their home countries. Provision of long-distance commercial services (such as order processing, invoice clearance, and software and database development) is also growing fast, thanks to computer and telecommunications networks such as the Internet. Though still in their infancy, long-distance services promise to be a large new segment of world trade.

In light of these considerations, and the broader trends discussed in last year's report, this report argues that measures that enhance the integration of lagging developing countries are likely to pay high dividends and are necessary to avoid the marginalization of these countries in the world economy. Growth and increased integration are mutually reinforcing, and both depend critically on the quality of policies and institutions. Increased participation in international trade improves resource allocation, enhances efficiency by increasing competition among firms, and induces learning and technology transfer, thus facilitating growth. And, as the East Asian countries show, faster output growth also tends to project countries onto regional and world markets. The higher returns associated with faster growth increase firms' demand for imported capital goods. As incomes rise, consumers demand more variety, as reflected in higher imports of consumer products. And faster-growing countries tend to attract more foreign investment.

The uneven distribution of foreign investment across developing countries and the wide differences in domestic investment rates suggest that, in a more tightly knit world economy, the quality of policies helps determine growth prospects. Other things being equal, investment flows toward countries that exhibit greater stability and that adopt policies to

improve the environment for foreign trade and investment. Countries where policies stand still can fall behind.

In reviewing the prospects for growth and integration of developing countries, this chapter pays special attention to the external factors that drive the prospects of regions or countries lagging in integration. The theme of lagging integration is picked up again in chapter 2, which examines the disparities in global integration, identifies their causes and implications, and reviews the prospects of lagging integrators in greater detail.

Favorable prospects for the coming decade

Developments in the world economy since the start of 1995 have been largely benign, with somewhat lower than expected G-7 growth accompanied by reduced pressure on already low inflation rates, unusually fast growth of world trade, and low nominal and real interest rates. Reflecting these developments and such policy factors as improved prospects for fiscal consolidation in industrial countries, our projections envisage a favorable international economic environment for developing countries in aggregate, although some will benefit much more than others (table 1-2). Compared with the preceding decade, factors favoring higher growth (besides the recovery of the transition economies of Central and Eastern Europe and the former Soviet Union) include the continued liberalization and fast growth of world trade and the lower level of real interest rates compared with those prevailing during much of the 1980s. There are, however, downside risks of slow OECD growth, to which the poorest countries are especially vulnerable.

Key features of the long-term projections include:

- The increased probability of a more stretched-out industrial country recovery, with growth continuing at modest but more steady rates and contributing to a more stable external environment for developing countries.
- Inflation and world real interest rates over the next decade that are likely to be lower than previously expected as a result of firm monetary policies, declining inflationary expectations, and continued fiscal consolidation in industrial countries.
- Private capital flows to developing countries that were unexpectedly resilient in the aftermath of the Mexico crisis. Factors such as moderate real international interest rates, continued liberalization in developing countries, and portfolio diversification in industrial countries are likely to support continued significant growth in private flows over the coming decade. But fiscal constraints and other pressures are unlikely to allow much room for growth in official aid flows.

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Developing countries should benefit from strong trade growth and moderate interest rates over the next decade

Table 1-2 Global conditions affecting growth in developing countries, 1974–2005
(average annual percentage change except for LIBOR)

Indicator	1974–80	1981–90	1991–93	1994	1995[a]	Current forecast 1996–2005	Last year's forecast 1995–2004[b]
Real GDP in G-7 countries	3.0	3.1	1.4	2.9	2.3	2.8	2.7
Inflation in G-7 countries[c]	10.0	4.3	3.2	2.2	2.1	2.6	2.7
World trade[d]	4.8	4.2	4.1	9.5	8.9	6.3	6.2
Nominal LIBOR (six months, US$)	9.5	10.0	4.6	5.1	6.0	6.1	6.6
Real six-month LIBOR[e]	0.2	5.2	1.0	2.4	3.3	3.3	3.6
Price indices (US$)							
G-5 export unit value of manufactures (MUV)[f]	11.6	3.3	2.1	3.6	4.5	2.5	2.3
Oil prices[g]	26.7	–5.3	–11.5	–9.0	3.5	–1.4	1.3
Non-oil commodity prices[g]	–1.5	–5.4	–4.8	17.8	4.7	–1.6	–1.1

a. Estimated.
b. Taken from *Global Economic Prospects 1995*.
c. Consumer price index in local currency, aggregated using 1988–90 GDP weights.
d. Average of merchandise export and import volumes.
e. Deflated by U.S. consumer price index.
f. Data for G-5 countries (France, Germany, Japan, the United Kingdom, and the United States) weighted by their exports of manufactures to developing countries.
g. Based on World Bank indices and deflated by the export price of manufactures.
Source: World Bank data and staff estimates.

- The current boom in world trade, which is expected to be followed by a decade of strong growth in trade volumes—averaging a little over 6 percent a year—including significant growth in trade between developing countries. These developments will be supported by implementation of the Uruguay Round and other trade liberalization initiatives, continued declines in transport and communications costs, and growth in foreign direct investment.
- The cyclical boom in non-oil commodity prices faded during the course of 1995. Over the long term commodity prices are expected to continue to decline in real terms, though a more gradual pace of decline than in the past decade is expected to contribute to a more stable environment for commodity-reliant developing countries. Real oil prices are projected to decline by more than 1 percent a year on average over the next decade—rather than rising by the same amount, as anticipated in last year's report—implying heightened pressure for adjustment and reforms in major oil exporters.

This broadly favorable external environment and the expectation of sustained reform underpin the projected acceleration of growth in developing countries (excluding the transition economies) from 3.4 percent

in 1981–90 and 5.0 percent in 1991–94 to 5.4 percent over the next ten years (table 1-3). The transition economies—the countries of Central and Eastern Europe and the former Soviet Union—are expected to consolidate their recovery and, indeed, to achieve higher growth than all other developing regions except East and South Asia. Though all developing regions are projected to match or exceed their growth performance of the past decade, the disparities among them will remain large, with Sub-Saharan Africa and the Middle East and North Africa registering only modest increases in per capita incomes.

These are trend projections, and cyclical fluctuations are bound to occur, though the likelihood of pronounced boom-bust cycles is low in the foreseeable future. However, there are industrial country sources of longer-term risk, discussed below. These include problems induced by aging populations in industrial countries, financial sector weaknesses in Japan, and the persistence of high unemployment in Europe.

Industrial country outlook: A stretched-out, low-inflation recovery

With few exceptions growth in the major industrial countries was lower in 1995 than in 1994 (figure 1-1). An easing in U.S. growth had been widely expected

Aggregate developing country growth should be markedly higher than in the past fifteen years

Table 1-3 World growth summary, 1966–2005
(annual percentage change in real GDP)

Region	1966–73	1974–80	1981–90	1991–94	1995ᵃ	Forecasts 1996–97	Forecasts 1996–2005
World total	5.1	3.4	3.1	1.5	2.8	3.1	3.5
High-income countries	4.8	3.0	3.2	1.7	2.5	2.6	2.9
OECD countries	4.7	2.9	3.1	1.6	2.4	2.6	2.8
Non-OECD countries	8.8	7.0	5.2	6.2	5.5	5.6	5.5
Developing countries	6.9	5.3	3.0	1.0	3.9	4.8	5.3
East Asia	7.9	7.1	7.9	9.4	9.2	8.2	7.9
South Asia	3.7	4.0	5.7	3.9	5.5	5.5	5.4
Sub-Saharan Africa	4.7	3.5	1.7	0.7	3.8	3.7	3.8
Latin America and the Caribbean	6.4	4.8	1.7	3.6	0.9	2.6	3.8
Europe and Central Asia	6.9	6.1	2.1	–9.0	–0.7	3.0	4.3
Middle East and North Africa	8.6	4.9	0.8	2.4	2.5	3.2	2.9
Memorandum items							
Eastern Europe and the former Soviet Union	7.0	5.1	1.8	–9.4	–2.5	2.9	4.4
Developing countries excluding Eastern Europe and the former Soviet Union	6.2	5.0	3.4	5.0	4.9	5.1	5.4

Note: GDP measured at market prices and expressed in 1987 prices and exchange rates. Growth rates over historical intervals are computed using least squares regression.
a. Estimated.
Source: OECD national accounts statistics; World Bank data, staff estimates, and projections.

as a result of tightening monetary policy over the course of 1994, but the failure of recovery to take hold in Japan and the slowing in Europe, which had only recently emerged from recession, was not anticipated. The outcome, a slippage in overall G-7 growth to 2.3 percent, was in keeping with the moderate, low amplitude character of the overall industrial country cycle. Annual G-7 growth never fell below 1 percent in the 1991–93 recession and reached a recovery peak of only 2.9 percent in 1994. Such patterns are in sharp contrast to the cycles of the mid-1970s and early 1980s, when growth was negative at recession troughs but approached 5 percent at subsequent recovery peaks.

Trends and their causes. In the United States growth is projected to continue within a sustainable 2.2–2.7 percent range. This positive outlook is based partly on the strengthening consensus among U.S. policymakers to move to a balanced budget over the next seven to ten years and partly on the large drop in U.S. long-term interest rates in 1995. In Europe, despite the unexpected slowdown, developments in 1995 such as significant monetary easing should enhance the prospects for a moderate revival in growth. In Japan growth remained stalled for the fourth year in succession. A substantial easing in mon-

Industrial country growth moderated in 1995

Figure 1-1 G-3 and G-7 real GDP growth, 1983–95
Percent
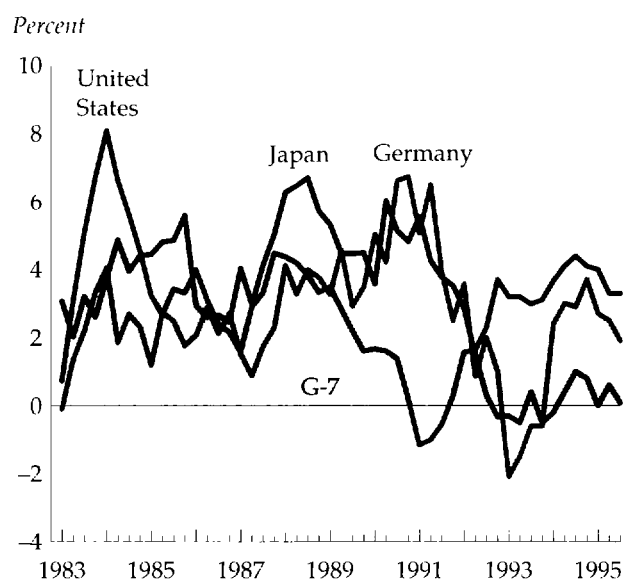
Source: IMF data.

etary and fiscal conditions during the second half of 1995 improved the likelihood of recovery from 1996 on, though financial system debt may contribute to a more muted and drawn-out pace than would otherwise be expected (box 1-1). With aggregate G-7 growth near most estimates of its long-run potential rate, inflation under control, and real interest rates at moderate levels, the most likely medium-term outlook is for neither boom nor bust but for an extended period of moderate, low-inflation growth. Smooth growth will provide a stable environment for continued reforms and international integration by the developing countries.

Consistent with moderate growth, average G-7 inflation (as measured by the consumer price index) edged down from 2.2 percent in 1994 to 2.1 percent in 1995 (see table 1-2). Long-term interest rates fell sharply as growth and inflationary expectations eased and as the likelihood of cutting industrial country fiscal deficits improved. Average real yields on G-7 ten-year bonds, which had risen by more than 220 basis points in the year to the fourth quarter of 1994, fell back 150 basis points over the subsequent four quarters to 3.9 percent, 50 basis points less than the 1986–95 average. Short-term rates also fell in Germany, Japan, and the United States and, by the

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Box 1-1 Japan's financial sector problems will affect developing countries

Because it accounts for about 20 percent of foreign aid to developing countries and 10 percent of their exports, Japan's economic health is important for low- and middle-income countries. The collapse of land and other asset prices in Japan since 1991 contributed to an increase in the bad debts of financial institutions to ¥42 trillion ($420 billion), or 9 percent of GDP, by September 1995. The associated reduction in the capital base of financial institutions has slowed credit extension and been an important factor in the country's long, drawn-out recession.

The concentration of bad debts in smaller financial institutions (regional banks, credit unions, mortgage institutions) has increased their exposure to bank runs, such as those affecting several institutions in the Tokyo-Kansai area in the second half of 1995. The possibility of a systemic financial sector crisis is, however, remote. Taking account of debt already written off and assuming recovery of 40 percent of collateral, about ¥18 trillion of bad debt (4 percent of GDP) remains to be disposed of. Given that bank profitability is supported by low interest rates and wide lending spreads, it is estimated that, at the current pace of writeoffs, it will take another two or three years for financial institutions to eliminate remaining bad debts.

The authorities will likely have to restructure severely affected institutions, resulting in higher fiscal expenditures. Studies of the U.S. savings and loan crisis, for example, suggest that cumulative losses (including misallocation of capital and the costs of the bailout) could run as high as 8 percent of GDP between 1982 and 2007 (Manchester and McKibbin 1994). By the late 1980s U.S. real long-term interest rates are estimated to have been pushed to a peak of about 50 basis points higher than would otherwise have been the case, and the U.S. dollar was 1.5 percent stronger than otherwise. Given the scale of the problem it seems likely that economic costs in Japan will also be large. Growth only averaged a little more than 1 percent a year in 1991–95, with real long-term interest rates averaging a little below U.S. rates and the real value of the yen surging during this time. The costs of restructuring will add to the structural deficit built up in efforts to combat the recession. These costs will add to the problem of a less favorable starting point

from which to confront the problems associated with a rapidly aging population.

The impact of Japan's fiscal strain on developing countries is likely to be most serious for indebted primary commodity exporters. Japanese demand for these products is adversely affected by slow income growth, and these countries benefit least from the demand for imported manufactures induced by a rising yen. Lower growth and higher interest rates in Japan will also continue to put pressure on commodity prices. Low-income countries are also likely to be affected by fiscal pressures on Japanese foreign aid. On the other hand many Asian exporters of low-cost manufactures to Japan will remain the least affected. Higher long-term interest rates will raise the debt servicing costs of indebted countries, while a stronger yen puts pressure on countries with a large share of yen-denominated debt.

Japan's financial markets have been experiencing negative growth

Capital gains and losses as a share of GDP, 1985–93
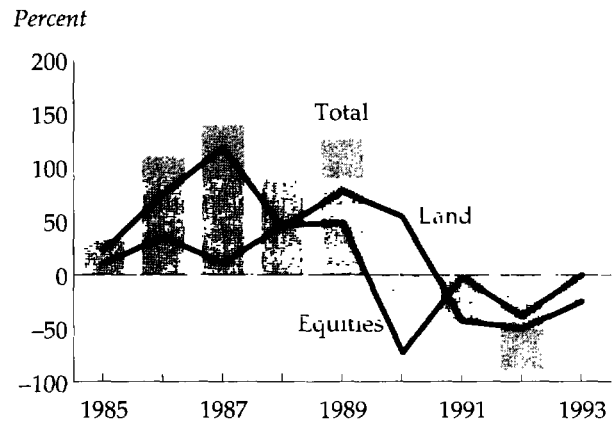
Percent

Source: Japan Economic Planning Agency data.

turn of the year, appeared poised to fall in several other countries as well.

Looking forward, real G-7 growth is expected to average 2.8 percent a year in 1996–2005, slightly above last year's projections, while inflation in these countries is expected to average 2.6 percent, a tenth of a point less than in last year's projections. This year's lower inflation projections reflect significant output gaps (the gap between actual output and that which could be produced if all resources were fully employed) in Japan and some European countries, more restrained fiscal and monetary policies in the approach to European monetary union, and increased competition arising from international trade. Progress on fiscal consolidation is expected to support lower real interest rates, with real six-month LIBOR expected to average 3.3 percent in 1996–2005, three-tenths of a percentage point less than was projected last year.

Rigidities in labor and product markets are an important element affecting long-run performance in industrial countries. Unemployment in Western Europe in particular remains high, at 10.8 percent in 1995, slightly below the 1994 peak of 11.2 percent. According to the OECD (1995a) high structural unemployment is caused by such labor market rigidities as restrictions on work time, high nonwage labor costs, barriers to entry for new firms, and product market rigidities that limit competition and demand. High structural unemployment in industrial countries has several adverse implications for developing countries and is an important source of risk in the long-run outlook. It reduces potential output and worsens inflation performance. It bolsters demands for unsustainably expansive macroeconomic policies that ultimately destabilize global conditions. And it generates pressures for more protectionist trade policies and more restrictive immigration policies.

An increasingly stable international economic environment. Rates of world output growth and inflation have become more stable in recent years, with important benefits for developing countries that are increasingly open to foreign trade and investment (figure 1-2). The business cycle of the early 1990s was mild compared with those associated with the oil shocks of the 1970s and the debt crisis of the 1980s. G-7 growth, inflation, and interest rates deviated less from their long-term averages in both the up and down phases of the cycle— one reason developing country output (excluding the former Soviet Union and Eastern Europe) grew by more than 4 percent a year even during the recession.

Four main factors account for the mildness of the current world business cycle. First, the 1991–93 recession did not involve supply shocks from oil or other commodity markets as large as those in the 1974–75 and 1980–82 recessions. Since oil demand is now only

1.5 percent of world GDP, down from 7.0 percent in the early 1980s, even a significant jump in current prices would have modest effects relative to the two previous shocks, which each represented about 3 percent of world GDP. In addition, a sustained increase in oil prices beyond $25 a barrel is considered improbable.

Second, industrial countries have maintained tight fiscal and monetary policies. Concerns about debt, aging populations, and the effect of taxes on incentives have supported a growing emphasis on fiscal consolidation. These efforts have helped lower inflationary expectations, and inflation fell through much of the 1980s and into the 1990s. High inflation, often caused by the monetization of fiscal deficits, increases economic instability, which is sometimes further exacerbated by the contractionary policies needed to curb inflation. In recent years tight monetary policies have been used to preempt the build-up of inflationary pressures early in the recovery process.

Third, integration through world trade rose quickly over the past decade. Higher levels and speeds of integration across countries are closely associated with less volatile growth and inflation (see chapter 2). The volatility of world trade was also lower in 1991–93, when continued import growth in developing countries helped mitigate recession in industrial countries. A recent analysis suggests that the high observed negative correlation between inflation and trade integration may reflect both greater competitive pressures and the higher costs of inflationary policies and exchange rate instability in more open economies (Romer 1993). Since 1970 the volatility of output was less than that of domestic demand in all but ten countries, underscoring the stabilizing effect of trade.

Fourth, financial integration has increased. Countries with sound policies gain access to international capital markets and benefit from the procyclical behavior of international interest rates and the possibility of borrowing to adjust to internal and external shocks. The international experience following the Mexican crisis suggests that the effect of external financial shocks greatly depends on the soundness of domestic macroeconomic policies. Countries with realistic exchange rates and low budget and current account deficits were hardly affected by the crisis.

The outlook for greater stability is also improved by long-run structural trends whose influence was overshadowed by the inflationary policies of the late 1960s and the oil shocks of the 1970s (Zarnowitz 1989). Most countries' share in output of services, a sector whose growth is not particularly volatile, is rising. For example, the share of services in output in the United States rose from 51 percent to 58 percent (in real terms) between 1977 and 1991, while the volatility of services growth, at 2 percent,[1] was less than half that for

Figure 1-2 Measures of stability in the global economic environment
(Average annual growth)

Low- and middle-income countries' GDP

Percent

```
5 ┐  Recession          25-year
                         average
4          Recovery
3
2
1
0 └─────
      Current          Average of two previous
    business cycle        business cycles
```

G-7 GDP

Percent

```
5 ┐
4                           25-year
           Recovery         average
3
2    Recession
1
0 └─────
      Current          Average of two previous
    business cycle        business cycles
```

World exports

Percent

```
10 ┐         Recovery
 8
 6   Recession        25-year
                      average
 4
 2
 0 └─────
      Current          Average of two previous
    business cycle        business cycles
```

G-7 inflation

Percent

```
12 ┐
10
                       25-year
 8                     average
 6
 4   Recession
          Recovery
 2
 0 └─────
      Current          Average of two previous
    business cycle        business cycles
```

US Treasury bills, three-month real annual average yield

Percent

```
2.0 ┐                   25-year
     Recession          average
1.5         Recovery
1.0
0.5
0.0 └─────
      Current          Average of two previous
    business cycle        business cycles
```

Real nonfuel commodity prices

Percent

```
20 ┐
15
10         Recovery
 5                     25-year
                       average
 0
-5   Recession
-10 └─────
      Current          Average of two previous
    business cycle        business cycles
```

Note: Current cycle: recession=1990–93; recovery=1993–94. Previous cycles: recession=1973–75 and 1979–82; recovery=1976–77 and 1983–84.
Source: World Bank data and staff estimates.

primary products, manufacturing, or utilities and construction. On the other hand inventories, a volatile element of aggregate demand, have halved as a share of U.S. GNP over the past ten years. "Automatic" stabilizers have also become more important in the postwar period. Although business cycles have not been abolished, recent experience suggests that the external environment of developing countries may be more stable than it has been in many years. Developing countries that integrate most rapidly with the global economy while pursuing sound policies will likely score the greatest gains from these favorable developments.

Better prospects for lower real interest rates

The dramatic fall in long-term interest rates in many countries was one of the most important developments of 1995, suggesting the potential for an extended period of low-inflation growth. In the year to the fourth quarter of 1995, ten-year bond yields dropped 200 basis points in the United States, 130 basis points in Japan, and from 50–100 basis points in the major European countries (figure 1-3). Broadly speaking, the declines reversed between half and three-quarters of the big jump in rates that had occurred in 1994. As noted above, reduced inflationary expectations and increased confidence about con-

tinued fiscal consolidation in industrial countries contributed to these declines.

Current projections are for real six-month U.S. dollar LIBOR to average 3.3 percent and for real ten-year U.S. bond yields to approach 4 percent over the coming decade. At these levels real interest rates would be roughly halfway between the low, recession-affected levels of 1991–95 and the higher levels in the pre-recession 1986–90 period. The projections are, however, critically dependent on continued progress in fiscal consolidation over the coming decade.

G-7 government deficits are projected to fall below 2 percent of GDP by the end of the decade, which would stabilize gross debt at 75 percent of GDP. Deficits in the G-7 rose from about 1 percent of GDP in 1989 to more than 4 percent in 1993 before falling to a still-high 3.3 percent in 1995. Deficits range from 1.6 percent of GDP in the United States to 7.5 percent in Italy. Gross government debt as a share of G-7 GDP has risen 15 percentage points, from 58 percent in 1989 to 73 percent in 1995.

Looming over these issues are the longer-term fiscal problems associated with aging populations in the industrial countries. In most OECD countries these pressures will accelerate over the next thirty years as the baby boom generation retires from the labor force. The ratio of the elderly, who tend to be low savers or dissavers, to the working population in the G-7 countries (except the United Kingdom) is projected to almost double by 2030–40, peaking at 60 percent in France, Germany, and Japan and at 70 percent in Italy (in contrast to still-low ratios in most developing countries). This development will tend to reduce OECD savings rates by an average of 1 percentage point and significantly exacerbate pressures on government finances. Public pensions account for about 10 percent of national income and 20 percent of government spending in most industrial countries. The present value of future net pension liabilities in the G-7 countries, however, is more than 130 percent of GDP (OECD 1995b and Mitchell 1993).

This prospect underscores the importance of achieving early progress on fiscal consolidation. For many countries a 1 percent of GDP improvement in the fiscal balance in 2000 will translate into 40–50 percent of GDP lower net debt by 2030. Conversely, fiscal slippage will have a negative impact on interest rates, especially when the longer-run effects of aging population on deficits are taken into account. OECD (1995b) calculations suggest that maintaining the U.S. budget deficit at current levels would result in a 50 basis point increase in real long-term interest rates. Such a rise in G-7 real rates would eventually reduce G-7 output by a quarter to one-half percent a year. The effect would be transmitted to the developing countries through lower exports, commodity prices, and private capital

Lower bond yields hold potential for low-inflation growth

Figure 1-3 Real ten-year government bond yields in G-3 countries, 1981–95
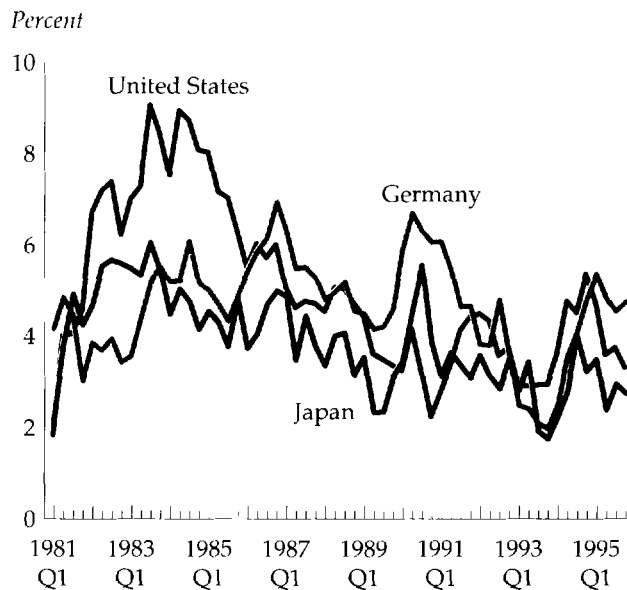
Percent

Note: Calculated as nominal yields less consumer price index inflation over previous four quarters.
Source: IMF data.

flows, and by higher debt service payments, resulting in 0.15 percent lower annual growth in low- and middle-income countries over a ten-year period. The highly indebted and primary commodity–reliant countries, such as those in Sub-Saharan Africa, would be most severely affected. The impact of substantially higher fiscal deficits resulting from aging populations would, of course, be correspondingly larger.

Private capital flows resilient, official aid limited

Private capital flows. The most striking aspect of aggregate private flows to developing countries in the aftermath of the December 1994 Mexican crisis has been their resilience. These flows reached an estimated $167 billion in 1995, up from $159 billion in 1994 and $154 billion in 1993. Thus after a dramatic, almost fourfold rise between 1990 and 1993, private flows have stabilized in the $160–170 billion range despite such shocks as the rise in U.S. interest rates during 1994 and the Mexican crisis (World Bank 1996).

Foreign direct investment rose 13 percent to a record estimated $90 billion in 1995, commercial bank lending also increased over the preceding year, bond issuance was flat, and only portfolio equity investment fell significantly, from $35 billion to $22 billion. Yet equity investment in stock markets is the most volatile and fickle type of investment, having multiplied some tenfold between 1990 and 1993, then halved from 1993 to 1995.

The Mexican crisis was also not a harbinger of a generalized crisis comparable, for example, to the 1980s debt crisis. Contagion effects on other emerging markets proved transient, as shown by money market rates, bond yields, and stock market prices in May 1995, just six months after the onset of the problem. By then stock prices in Chile and a number of East Asian markets had already exceeded precrisis levels. Stock prices in Argentina and Brazil were lower but could be explained by weaknesses in banking systems and preexisting bearish market trends, rather than pure contagion.

The Mexican crisis offered several lessons for countries pursuing greater integration in world capital markets. One is that countries trying to establish low inflation credentials cannot adhere to nominal exchange rate pegs indefinitely without regard to current account deterioration. That is, exchange rate management needs to be flexible. Another is that if capital inflows fuel a consumption boom disproportionate to investment, then warning signals should flash. Consumption in Mexico grew faster than investment, to the detriment of growth. A third is that capital account liberalization is risky if banking systems are inadequately capitalized, ineffectively regulated, and poorly supervised. Finally, the composition of

capital inflows matters: both the balance between foreign direct investment and portfolio equity flows, and the extent of short-term borrowing; Mexico depended too much on "hot money" portfolio equity and short-term borrowing.

These considerations suggest that occasional setbacks to aggregate private flows may—and probably will—occur in the future. But a number of factors suggest that private flows, while not achieving the dramatic growth of the early 1990s, are likely to achieve continued modest growth. One is the projection of moderate industrial country real interest rates discussed earlier. Growth in foreign direct investment will likely be underpinned by structural factors such as falling transport and communications costs, the rise of regional trading arrangements, and continued economic reform in developing countries (including liberalization of investment regimes and continued privatization).[2] The ongoing international diversification of investment portfolios in industrial countries is likely to continue propelling growth in portfolio flows. Investment funds dedicated to emerging markets grew from 232 in 1990, with assets of $14 billion, to more than 1,000 by mid-1995, with assets of $123 billion.[3]

Developing countries' access to private flows has always been highly differentiated. The Mexico crisis increased this differentiation. Today about twenty developing countries have access to the private markets for bonds, commercial bank loans, and portfolio equity; the rest are shut out by a lack of creditworthiness. Among those with market access borrowing terms vary widely. For example, in 1995 new bond issues by East Asian borrowers averaged a maturity of nearly twelve years with a spread of 116 basis points over comparable government benchmark issues. Latin American borrowers could only obtain three-year maturities, for which they paid a spread of 336 basis points (World Bank 1996). For countries that have been slow to integrate with global markets, the message is clear: isolationism carries high costs in terms of forgone finance, inhibited investment, and expensive and often misallocated domestic credit.

Foreign direct investment. Foreign direct investment falls on the borderline between a financial flow and a real linkage, like trade. Sales of foreign affiliates of multinational corporations exceed global exports of goods and services (table 1-4). Their total worldwide sales of $5.3 trillion in 1992 (the latest year available) compare with worldwide exports of goods and nonfactor services of $4.6 trillion. The sales of foreign affiliates located in developing countries totaled $1.3 trillion, compared with exports to developing countries of $1.0 trillion.

Part of the reason foreign direct investment in developing countries has grown so fast—and is

Table 1-4 Sales of foreign affiliates of multinational corporations, 1992
(billions of US dollars)

Origin	Amount
Worldwide sales of foreign affiliates	5,325
Located in developing countries	1,331
Located in industrial countries	3,994
Global exports of goods and services	4,570

Source: World Bank staff estimates, based on UNCTAD data.

expected to continue to grow rapidly—is the revolution in developing country investment regimes in the 1990s, embodying the shift in attitudes from sovereign discretion to the free flow of foreign investment. Half of all investment codes and bilateral treaties on investment were drawn up in the 1990s,[4] as were many important multilateral instruments, including the Uruguay Round's Trade-Related Investment Measures, Trade-Related Investment Practices, and the General Agreement on Trade in Services; World Bank guidelines and Asia-Pacific Economic Cooperation nonbinding principles; and regional agreements bearing on foreign investment (North American Free Trade Agreement, Lome IV, Mercosur). Countries that have followed open admission policies include many of those in Central and Eastern Europe, the former Soviet Union, and Latin America. Nearly all these laws, treaties, and instruments espouse substantial liberalization, especially with respect to scope, admission, and the settlement of disputes.

Aid flows. The widely differing prospects for capital flows by country are brought into focus by the poor prospects for aid flows. In 1994 official development assistance constituted a third of net resource flows to low- and middle-income countries (excluding transition economies), and nearly two-thirds of net resource flows to low-income countries. For many of the poorest developing countries official development assistance represents virtually the only source of external financing and accounts for a significant share of income. In Mozambique in the early 1990s, for example, it equaled two-thirds of GDP. Yet in recent years aid flows have been falling, from 0.35 percent of donors' GDP in fiscal 1983 to 0.29 percent in 1994, the lowest level in more than twenty years. Recent cuts have been almost universal, with just four of twenty-one donors reporting program increases in current dollars.

These trends are likely to continue for several reasons. First, the need for fiscal consolidation is press-

ing in most industrial countries. Second, the end of the Cold War has reduced (though far from eliminated) the substantial military and strategic rationale for official assistance and made it subject to the greater skepticism in recent years about the effectiveness of government action in general. Moreover, the breakup of the Soviet Union and the collapse of socialism in Eastern Europe eliminated a major source of aid for some developing countries while creating a new source of demand for it (figure 1-4). Third, in recent years relief aid for humanitarian disasters such as those in Rwanda and Bosnia may have diverted funds from development purposes. Finally, the effectiveness of aid as administered over the past thirty years is under considerable scrutiny.

The implication of these trends for low-income countries is that they will become increasingly less able to rely on development flows and will have to develop a more welcoming environment for private financing. The effectiveness of official development assistance will become an increasingly important criterion in its allocation. Thus developing countries will have to meet even tougher policy requirements in order to receive aid. For donor countries, improving the coordination of aid delivery at the country and local levels will be essential, so as to minimize the inefficiencies that have sometimes plagued assistance efforts in the past.

Continued fast growth in world trade

The rebound in world trade that commenced in 1994 continued in 1995, with trade volumes growing at about 9 percent, just below the 9.5 percent rate of 1994. Over the longer term, world trade growth is projected to average 6.3 percent a year during 1996–2005, about the same pace as achieved during the second half of the 1980s. With world output growing 3.5 percent a year over the coming decade, global trade integration (as measured by the ratio of trade to GDP) is expected to rise 2–3 percent a year, continuing the rapid pace experienced in the past decade (figure 1-5 and table 1-5).

Industrial country import growth, which rose through 1993 to hit 10.5 percent in 1994, decelerated to a still-healthy 7.6 percent in 1995. Slower economic growth in the United States and the European Union contributed most to the easing. By contrast, import growth remained firm in Japan, where the strong yen, rising imports of manufactured goods from offshore production sites, and continued market opening and deregulation outweighed the effects of the lingering recession.

International trade activity in developing countries was even more buoyant. Overall import growth among the low- and middle-income countries rose an

Figure 1-4 Developing regions' share in total official development assistance, 1970–93
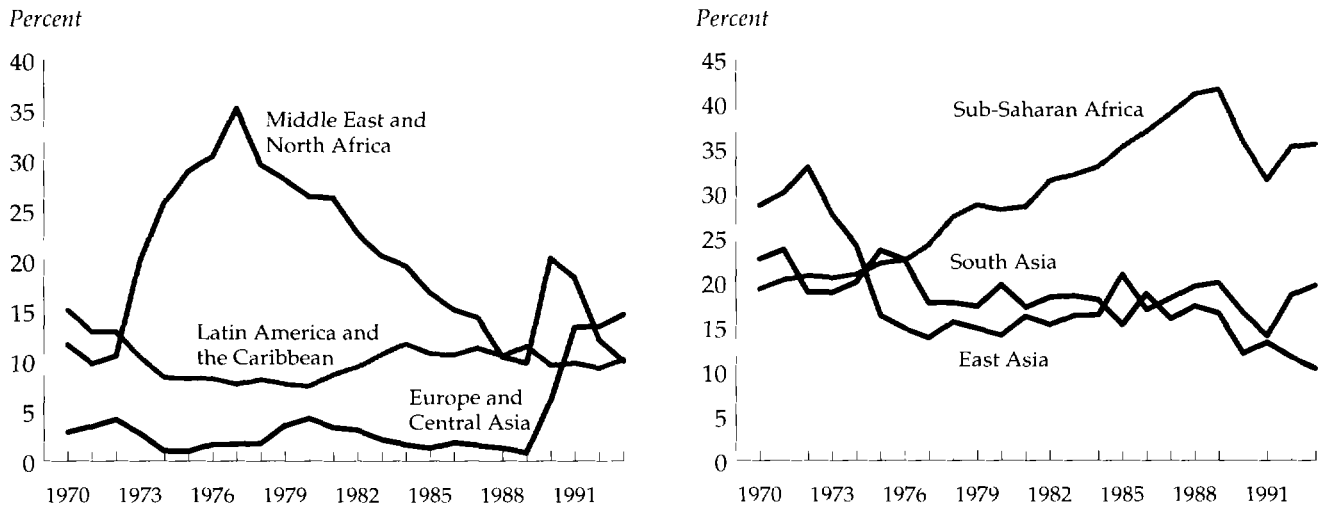
Percent

Percent

Source: World Bank data and staff estimates.

estimated 10 percent despite a sharp downturn in Latin America. Import demand continued to boom in East and South Asia and accelerated in the transition economies of Europe and Central Asia. Developing country export growth also jumped, by about 4.5 percentage points, to nearly 13 percent.

After an ebullient expansion averaging nearly 16 percent a year in 1991–93, Latin American imports fell an estimated 3 percent in 1995, largely as a result of the downturn in private capital flows to Mexico and Argentina and the macroeconomic adjustments this downturn required. The region's exports boomed, however, rising 10 percent in 1995 as exchange rates were depreciated and lower domestic demand growth freed resources for exports. The main exception to the regional pattern was Brazil, where substantial real exchange rate appreciation and a consumption boom contributed to a surge in imports and a drop in exports. The longer-run prospects for Latin American trade are promising thanks to the extensive liberalization of the past decade: trade volumes are projected to average growth of nearly 6 percent during 1996–2005, 4 percentage points more than in the 1980s, with export growth outrunning import growth as the region continues to move toward more sustainable external financial positions.

Trade activity in East and South Asia continued to boom due to strong domestic demand and increased capital goods imports to support fast-growing export sectors. East Asian economies were among the principal beneficiaries of the competitiveness boost resulting from the yen's appreciation in the first part of 1995. The

Steady global output growth should facilitate integration

Figure 1-5 World exports/GDP and GDP, 1971–97
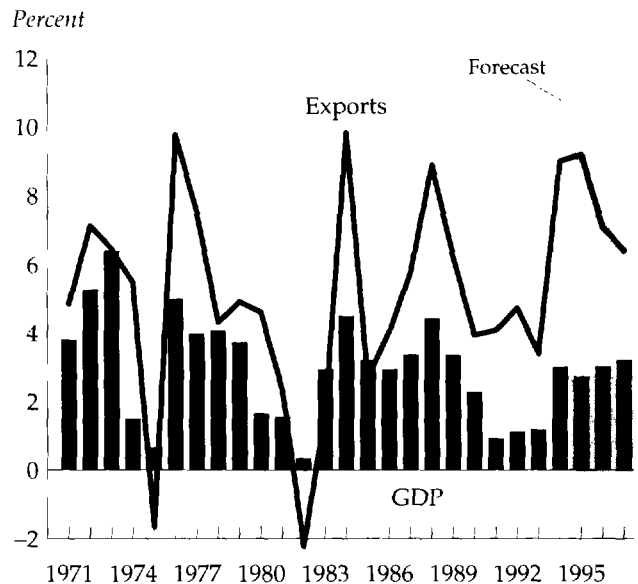
Percent

Source: World Bank data and staff estimates.

boom of recent years in South Asia's international trade activities continued, with both exports and imports rising 10–15 percent. Trade volumes also rose rapidly in the early reforming economies of Eastern Europe as economic recovery took hold. Imports of

13

Table 1-5 World merchandise trade, 1981–2005
(percent)

Indicator/region	1981–90	1991–93	1994–95	1996–2005[a]
World trade growth[b]	4.1	4.0	9.2	6.3
World output growth	3.1	1.4	2.9	3.5
Export growth by region				
High-income countries	4.8	3.7	8.7	6.0
OECD countries	4.6	2.9	8.1	5.8
Non-OECD countries	7.8	11.2	13.0	7.5
Low- and middle-income countries	2.4	6.6	10.6	7.5
East Asia	9.3	14.1	17.4	10.2
South Asia	5.6	10.8	10.1	7.2
Sub-Saharan Africa	0.0	0.5	2.6	4.8
Latin America and the Caribbean	4.4	9.3	8.8	6.1
Europe and Central Asia	–0.5	–3.8	10.2	5.1
Middle East and North Africa	–1.6	4.6	0.6	4.1
Import growth by region				
High-income countries	5.0	3.0	9.4	5.8
OECD countries	4.8	1.8	9.0	5.5
Non-OECD countries	7.3	14.3	12.0	7.4
Low- and middle-income countries	1.4	7.1	9.0	8.2
East Asia	7.0	14.6	16.7	10.7
South Asia	4.2	5.5	14.9	8.1
Sub-Saharan Africa	-3.7	2.0	2.5	5.5
Latin America and the Caribbean	-0.3	16.3	3.9	5.8
Europe and Central Asia	0.7	-5.2	5.4	5.9
Middle East and North Africa	-0.8	3.1	-0.1	5.9

a. Estimated.
b. Growth rate of the sum of merchandise export and import volumes.
Source: World Bank data and staff projections.

capital goods grew quickly as increasing financial inflows relaxed foreign exchange constraints. Association agreements with the European Union contributed to export growth. Import demand in Sub-Saharan Africa also picked up as the higher level of commodity prices relative to the early 1990s improved export earnings and as recovery continued in South Africa. Continued growth in industrial countries and more realistic exchange rates in the Communauté financière africaine (CFA) zone and other countries contributed to a pickup in African export growth.

The long-term forecast of buoyant world trade growth averaging 6.3 percent a year is underpinned by a number of factors, including the continuing trend toward widespread trade liberalization, regional trade arrangements, and unilateral liberalization on the part of many developing countries. The median unweighted average tariff rate in a sample of forty-eight developing countries, for example, fell by 9 percentage points (or 34 percent) between the mid-1980s and early 1990s, with the largest drops occurring in

Latin America, South Asia, Eastern and Central Europe, and East Asia; changes in Sub-Saharan Africa and the Middle East and North Africa were relatively negligible. Strong trade growth will also be supported by falling communications costs and, despite a pause in early 1995, the long-run trend toward rising private capital flows to developing countries. Trade between developing countries has grown fast, showing that rising developing country exports do not necessarily encroach on industrial country markets (box 1-2).

Commodity prices: Flattening in real terms

The World Bank's index of non-oil commodity prices rose by close to 5 percent in real terms in 1995 after an 18 percent surge in 1994. In many cases, however, prices were slipping over the course of 1995 so that, for the most part, the commodity price boom that started in 1993 appears to be over, having been primarily the result of transitory supply disruptions and normal cyclical forces. The projections are for the

overall non-oil price index to fall by more than 15 percent in real terms over 1996–97, returning about two-thirds of price gains seen in 1994–95, and to remain broadly flat in the medium term, in contrast to the major declines of the past 15 years (figure 1-6).

Prices are expected to be restrained in the longer term by rising agricultural productivity in many countries, low income elasticities for most staple food items, and the declining material intensity of economic activity in industrial countries. Thus commodity-exporting developing countries cannot look to significant price increases as a sustainable source of export revenue growth. On the other hand flat prices will be an improvement on the protracted and large price declines suffered during the 1980s and early 1990s and will provide a stable environment in which to pursue long-term economic reforms.

In some respects movements in individual commodity prices in 1995 were less favorable to developing countries than in 1994. Prices for beverages, which are important for many small commodity exporters in Africa and Latin America—and which rose by more than 70 percent in real terms in 1994—turned down in

1995. Price increases in 1995 were led by grains, a significant import item for many low-income countries, notably those in Africa.

Wheat, rice, and corn experienced particularly steep price increases in 1995. The main factors behind grain price increases were rising demand, supported by the world recovery, poor harvests in the United States and the former Soviet Union, and cuts in price supports and subsidies in the United States and Europe. Stocks are expected to fall to 13 percent of consumption by the end of the 1995/96 crop year, the lowest reserve on record. The market is expected to remain tight, with high and volatile prices through 1996. The possibility of further supply constraints brought about by poor weather, for example, cannot be ruled out, making this potentially the most volatile situation in the past fifteen years. Thus the current situation is not viewed as the beginning of a period of sustained real price increases, but rather as a short-term response to the current imbalance between supply and demand. If prices were to remain high, production by the major exporters could increase significantly. And prices may begin to

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Box 1-2 Developing country regional trade: A bonus of global trade integration

The export pessimism that led many developing countries to enter into the inward-looking and largely unsuccessful "South-South" regional trading arrangements of the 1970s and early 1980s has been widely replaced by outward-oriented trade policies and a resurgence in global trade integration. Ironically, it is in this liberalized trading environment that intra–developing country trade has flourished, averaging 12 percent annual growth in nominal dollar terms during 1985–94, even more buoyant than the 10 percent annual growth in developing country trade with OECD countries during this period. The wave of trade liberalization in developing countries over the past decade—often unilateral—has led to a gradual shifting of productive resources toward areas of international comparative advantage.

The share of intra–developing country trade in world trade increased from 5 percent in 1970 to 13 percent in 1994 thanks to manufactures, whose share in this trade rose from 56 percent to 75 percent over the past decade. Less than 10 percentage points of this shift can be attributed to relative price changes favoring manufactures.

The figure shows that trade within the major developing country regions in 1985–93 grew most rapidly in East Asia and Latin America (average annual rates of 22 percent and 16 percent). Starting from a small base, it has also grown in South Asia and Sub-Saharan Africa (average annual rates of 9 percent and 8 percent). There was no growth in intraregional transactions in the Middle East and North Africa during this time. Growth in intraregional trade is not shown for Europe and Central Asia because of the lack of reliable trade data for the republics

of the former Soviet Union, the former Yugoslavia, and the Czech and Slovak Republics. Trade complementarities for the region are not shown for the same reason. The region is extraordinarily heterogeneous, comprising countries from Western Europe (Greece, Turkey), former members of the Council for Mutual Economic Assistance from Eastern Europe (Hungary, Poland, the Czech Republic), and the former Soviet republics. Intraregional trade collapsed following the end of Council for Mutual Economic Assistance but has since, in Eastern European countries, undergone a sharp reorientation toward the European Union (see chapter 3). The complementarity of intraregional trade—the extent to which a country's exports match trading partners' import needs—rose markedly in Latin America, which underwent substantial trade liberalization over the past decade, and in East Asia, where trade protection was also significantly reduced over this period.

Other factors affecting the growth of developing country intraregional trade include the dynamism of regional growth and access to external financing. The dramatic growth of East Asia's intraregional trade was supported by rapid regional economic growth and large capital inflows. In Sub-Saharan Africa low intraregional trade complementarities, scarce financing, and relatively stagnant output growth kept intraregional trade growth low. In Latin America the resurgence of capital flows in the early 1990s allowed higher import levels and thus contributed to the growth of intraregional trade.

Box continues on next page.

Box 1-2 (continued)

Trade among developing regions has grown rapidly

Developing country intraregional trade and the factors affecting it, 1985–93

Intraregional trade growth

Percent

Sub-Saharan Africa | South Asia | East Asia | Middle East and North Africa | Latin America and the Caribbean

Regional real output growth

Percent

Sub-Saharan Africa | South Asia | East Asia | Middle East and North Africa | Europe and Central Asia | Latin America and the Caribbean

Accumulated net private resource inflows

US$ billions

Sub-Saharan Africa | South Asia | East Asia | Middle East and North Africa | Europe and Central Asia | Latin America and the Caribbean

Complementarities for intraregional trade

Index

1993
1985

Sub-Saharan Africa | South Asia | East Asia | Middle East and North Africa | Latin America and the Caribbean

Source: World Bank data and staff estimates.

fall if productivity increases continue to outstrip demand.

Prices for agricultural raw materials like cotton and rubber rose substantially in 1994 and early 1995 because of supply scarcities but were relatively flat for the rest of 1995. Rubber prices are likely to remain above their long-term trends for the next three years or so because of a lack of new tree plantings. Metals

and minerals prices have stayed on an upward trend, led by copper and aluminum. These prices are likely to remain especially firm because of a lack of new investment in recent years.

Although oil prices recovered somewhat from their 1994 lows to an average of $17 a barrel in 1995, real prices remained at their lowest level in more than twenty years. Prices continue to be depressed by sur-

plus capacity and by OPEC's inability to increase market share. In recent years global demand increases have tended to be captured by non-OPEC supplies, particularly from the North Sea and Latin America— a situation expected to continue for the next few years. The growth in supply has been fostered by improvements in oil exploration and production technologies, increased competition and liberalization in the energy sector, privatization of public oil companies, and a more welcoming stance toward multinational oil companies on the part of such countries as Algeria, Iran, and Venezuela (Streifel 1995). Additional supply may come from resumed Iraqi exports at some point in the future and from an increase in exports by countries of the former Soviet Union. The cumulative impact of these bearish supply influences is expected to cause real oil prices to fall significantly in 1996–97, with 1997 prices 12 percent lower than 1995 levels in real terms, and then to remain relatively flat through 2005, implying a 1.4 percent annual average decline.

## A differentiated outlook for developing countries

In some ways the prospective external environment for developing countries summarized in preceding sections may be among the most favorable in many decades. Positive factors include moderate low-inflation growth in industrial countries, real interest rates substantially lower than during the 1980s, buoyant growth in world trade, and a strong upward trend in private capital flows to developing countries. In this environment developing country GDP (excluding the transition economics) is projected to average 5.4 percent annual growth during 1996–2005, up from 4.4 percent in 1986–95, or 5.3 percent (including the transition economies), up from 2.1 percent over the past decade. In addition to the positive influence of a better external environment, the projected improvement in aggregate developing country growth also reflects the swing to positive growth in the transition economies and the rising share of the fast-growing East Asian region in developing country output.

There are two important qualifications to this favorable baseline scenario. First, it will depend on continued significant policy adjustments in industrial countries. Key assumptions here include substantial reductions in fiscal deficits, sustained anti-inflationary resolve, structural reforms to address high unemployment, especially in Europe, and continued strong momentum on global trade liberalization.

Second, the buoyant overall projections for low- and middle-income countries mask a wide range of individual outcomes. The outlook is most favorable for those developing countries that continue to implement macroeconomic and structural reforms and that develop institutions and infrastructure to exploit the

Figure 1-6 Real commodity prices, 1960–2005
(deflated by the MUV index)

Index (1990=100)
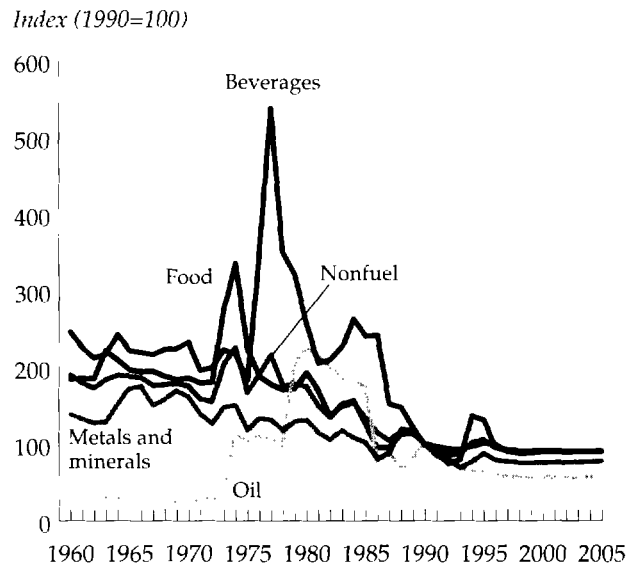
MUV is manufactures unit value.
Source: World Bank data and staff projections.

opportunities offered by an expanding but increasingly competitive global economy. A number of current and prospective trends in the external environment, however, suggest that growth prospects for countries that are lagging in integration will be modest at best (see chapter 2). These trends include a continuing decline in the share of primary commodities in world trade, growing and intense competition in labor-intensive manufactures markets from low-income countries like China and India, growing constraints on foreign aid flows and the complementary need to attract private foreign financing and investment (or, indeed, to avert large-scale flight of domestic capital and skilled labor), and growing constraints on the growth of worker remittances.

Much of the estimated acceleration in low- and middle-income countries' growth, from 2.5 percent in 1994 to around 4 percent in 1995, derived from improvements in the transition economies of *Europe and Central Asia*. Growth in these countries rose to 4.8 percent from just over 2.0 percent in 1994, led by early reformers such as Poland and the Czech Republic. Many of these countries have moved determinedly toward global integration, with booming foreign direct investment inflows and exports contributing significantly to revival (see chapter 3). In the republics of the former Soviet Union economic contraction eased to a little over 5 percent in 1995 from more than 14 percent in

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1994, led by postreform lows in inflation and budget deficits in Russia. Exports to markets outside the former Soviet Union have been buoyant, and positive growth is expected to emerge from 1996 on. On the downside, economic conditions remain difficult in the Central Asian and Caucasus republics, many of which share features with weak and lagging integrators. Overall, though, the 4–5 percent long-run growth forecast for the region will contribute half of the 3.2 percentage point increase in developing country growth over the next decade.

Much of the rest of the improvement in aggregate developing country growth is expected to come from two regions—*East and South Asia*—where global integration will remain at or come to the forefront of the development agenda. East Asian growth eased marginally to about 9 percent in 1995 as the Chinese economy, where growth fell from near 12 percent to just over 10 percent, moved toward a soft landing. But growth accelerated or continued at high rates in most other countries of the region on the basis of rapid export growth, led by burgeoning intraregional trade, strong domestic demand, and continued large private capital inflows. In South Asia booming exports and a continued rise in foreign direct investment inflows supported another year of near 6 percent growth in India. But countries in the region will continue to face tough challenges if they are to sustain the rapid pace of growth and integration of recent years. These include dealing with infrastructure bottlenecks, fiscal deficits, military expenditures, and inefficient public sectors, as well as lowering high trade and investment barriers and extending the scope of competition in domestic factor and product markets.

Latin America and the Caribbean was the only developing region that experienced a substantial slowdown in 1995—regional growth dropped from near 5 percent in 1994 to less than 1 percent. The slowdown was led by recessions in Mexico and Argentina, where a sharp downturn in private capital flows in the wake of the Mexican crisis forced a sudden adjustment in domestic consumption and investment to close large current account deficits built up after several years of real currency appreciation, low domestic savings, and externally financed growth. Regional growth is expected to remain sluggish in 1996–97 as a result of a projected (though moderate) adjustment in Brazil, where strong current growth is also associated with real appreciation, a consumption boom, and burgeoning external deficits. Many countries in the region that underwent macroeconomic adjustment in 1995 have shown a resolve to persist with and even strengthen policy reforms. This factor underpins a projection of long-term regional growth (2001–05) reviving to just over 4 percent.

Sub-Saharan Africa experienced an upturn in growth

to 3.5–4.0 percent in 1995 after averaging 0.7 percent a year in 1991–94. This recovery was due in part to improved commodity prices but also to the effect of reforms undertaken by a number of countries, including those of the CFA zone. South Africa's recovery continued for a second year, and spillover benefits—in part through increased trade and investment flows—should begin to accrue to the Southern African area. But the large number of countries in the Sub-Saharan region and the considerable variation in growth rates suggest the need to look behind the regional averages (figure 1-7). Many countries persisting with structural adjustment (such as Ghana, Tanzania, and Uganda) have recovered sharply from declines during the 1980s. Others (such as Botswana and Mauritius) continue their strong performance of earlier years. At the opposite pole, countries suffering from civil strife (such as Liberia, Rwanda, Somalia, and Zaire) continue to suffer contraction (accurate data are not available for some of these countries). Expectations for an improvement in regional growth over the next decade to 3.5–4.0 percent are conditioned on a number of assumptions. Among these are a continuation in the recent pace of reforms, a slower rate of decline in terms of trade, and a consolidation of civil peace in the sub-

Sub-Saharan Africa remains a region of contrasts

Figure 1-7 Annual GDP growth in Sub-Saharan Africa, 1992–94
(percent)
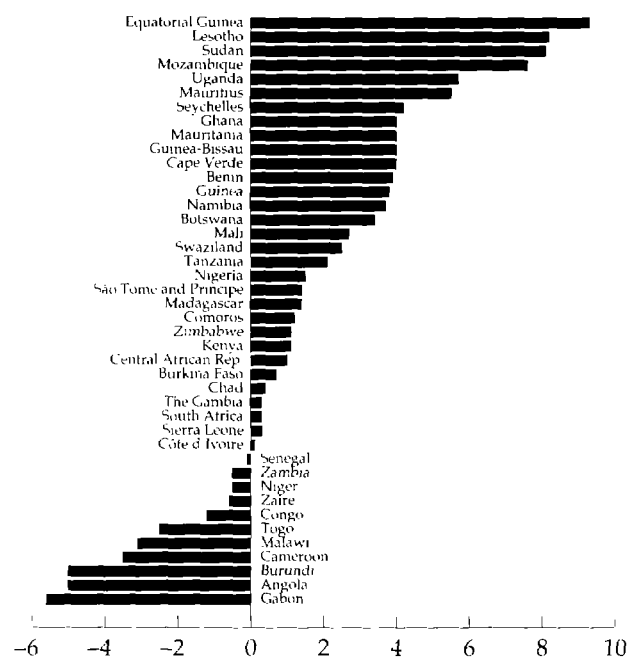
Source. World Bank data and staff estimates.

regions where breakthroughs have recently been achieved. Still, given the low projected rate of per capita income growth, the prospects for poverty reduction remain modest.

The *Middle East and North Africa* grew a sluggish 2.5 percent in 1995 following barely positive growth in 1994, in part reflecting weak oil prices. Severe drought also reduced output, particularly in Morocco and Tunisia. Real oil price declines averaging more than 6 percent a year in 1981–95 were a major factor in average annual regional growth of just over 1 percent in 1986–95. As the section on commodities explained, current projections for oil prices are notably more bearish than in last year's report, with an average annual drop in real prices of 1.4 percent expected over the next decade rather than an average annual rise of 2 percent. Regional growth is projected to average 2.9 percent a year over the next decade, the lowest among all developing regions, combined with more differentiation in performance within the region. Key issues affecting the region's long-run outlook and relative performance include progress on structural reforms, which up to now has been sporadic at best; greater integration with the world economy, especially in terms of formal arrangements with the European Union; progress in regional peace; and institutional development to alleviate sociopolitical tensions.

Conclusion

These projections paint an aggregate picture of rapid growth and further advances in the integration of developing countries with the world economy over the next ten years. Some countries will prosper; others, including some of the poorest, are likely to expe-rience only moderate rates of growth. Industrial country growth will be modest, but inflation and interest rates will remain moderate and world trade will grow rapidly. Wide disparities will persist in growth rates across developing countries, and these disparities will be reflected in (and, to some extent, be the reflection of) the pace at which countries are becoming integrated with the global economy.

This outlook suggests a number of issues. What are the causes and the implications of lagging integration? Do countries that want to become more integrated with the world economy face insurmountable obstacles in the form of international trade barriers and the high cost of liberalization? Can commodity-dependent countries, which tend to lag in growth and integration, break out of their vicious cycle? These questions are addressed in chapters 2, 3, and 4.

Notes

1. Calculated as the standard deviation of annual growth rates over the period 1970 to 1994.

2. During 1990–95 developing countries attracted nearly $40 billion in foreign direct investment to privatization programs.

3. However, extravagant projections about the impact of portfolio diversification should be tempered by evidence that investors exhibit "home bias," that is, they tend to invest less abroad than diversification theory would suggest (Tesar and Werner 1993). Portfolio diversification also increases short-term volatility, since emerging markets represent a small fraction of total investments.

4. These numbers refer to all legal instruments known to the International Center for the Settlement of Investment Disputes, an arm of the World Bank Group.

Disparities in global integration

Developing countries as a group have participated extensively in the acceleration of global integration, although some have done much better than others. Over the past decade their overall ratio of trade to GDP—a common measure of integration—rose 1.2 percentage points a year, while their share of global foreign direct investment (FDI) rose to two-fifths. But there are wide disparities in global economic integration across developing countries. This chapter reviews developing countries' widely varying experience with integration over the past ten years and explores the causes and implications of the large disparities. (Box 2-1 considers the experience of global integration from a historical perspective.) The analysis draws four main conclusions:

- Changes in integration were highly differentiated. Many developing countries became less integrated with the world economy over the past decade, and a large divide separates the least from the most integrated. It is striking, for example, that the ratio of trade to GDP fell in forty-four of ninety-three developing countries over the past ten years, while the ratio of FDI to GDP fell in more than a third.
- Countries with the highest levels of integration tended to exhibit the fastest output growth, as did countries that made the greatest advances in integration. Many low-income countries are among the least integrated, however, and some became even more marginalized during this period, experiencing both falling incomes and reduced integration. But other low-income countries—including some of the largest—were among the fastest integrators.
- Sound policies play an important role in determining both growth and the speed of integration. Policy reforms designed to increase an economy's growth and stability are likely to influence a country's speed of integration, both directly and through their effect on

growth. Reforms that promote stable macroeconomic conditions, realistic exchange rates, and open trade and investment regimes are also important for growth and integration.
- Improvements in the external environment and modest reforms in many lagging integrators suggest that their growth rates may show some improvement in the next decade. But if current policies and trends persist, many developing countries can expect to fall further behind OECD countries in per capita GDP.

Explaining disparities in integration

Global economic integration—participation in the international markets for goods, services, capital, and labor—can be measured in several different ways. One approach is to try to capture the degree to which domestic prices and interest rates reflect their international counterparts: if markets were perfectly integrated, prices would be the same everywhere. A measure of the extent to which a country has absorbed the global stock of technological and other knowledge would also be useful. But in practice such measures are hard to calculate. This chapter examines direct measures of integration, such as ratios of trade to GDP and FDI to GDP, as well as indirect measures, such as creditworthiness ratings (a measure of access to international capital markets), tariffs (an indicator of disparities between domestic and international prices), and the share of manufactures in exports (an imperfect measure of a country's ability to produce at world standards and absorb technical knowledge). There is an element of arbitrariness in this selection. A number of other measures could also have been used, including exchange controls, quantitative restrictions on imports, or institutional factors such as membership in the World Trade Organization. But whatever the measure, most indicators point to the same conclusion: developing countries show wide disparities in both the level and the rate of integration.[1]

Measures of integration

Trade ratios advanced strongly in some regions in the past ten years, though they fell in Sub-Saharan Africa, were flat in the Middle East and North Africa, and barely edged forward in South Asia (figure 2-1).[2] Overall, trade ratios fell in forty-four of ninety-three developing countries, representing more than one billion people, or 26 percent of the sample population.[3] A further seventeen countries experienced only modest rises. And although the aggregate ratio of developing country trade to GDP rose strongly over the decade, three-quarters of the increase was accounted for by just ten countries. Changes in ratios of trade to GDP matter because competition in global markets exposes exporters to new technologies, designs, products, and management techniques and provides access to imports that were previously unavailable or that embody new technologies that can contribute to productivity gains. Ratios of trade to GDP may also provide indirect measures of competition and price allocation effects. For example, Coe, Helpman, and Hoffmaister (1995) find that the size of spillovers from research and development in industrial countries on productivity in developing countries rises with developing country imports from OECD countries. Such spillovers may account for most of the rise in developing countries' total factor productivity in 1971–90.[4]

Levels of and changes in tariffs also vary widely across developing regions (figure 2-2). Tariff levels matter because they, together with other trade restric-

Trade expanded in many regions over the past decade

Figure 2-1 Changes in real trade/GDP, 1960–94
(percent)
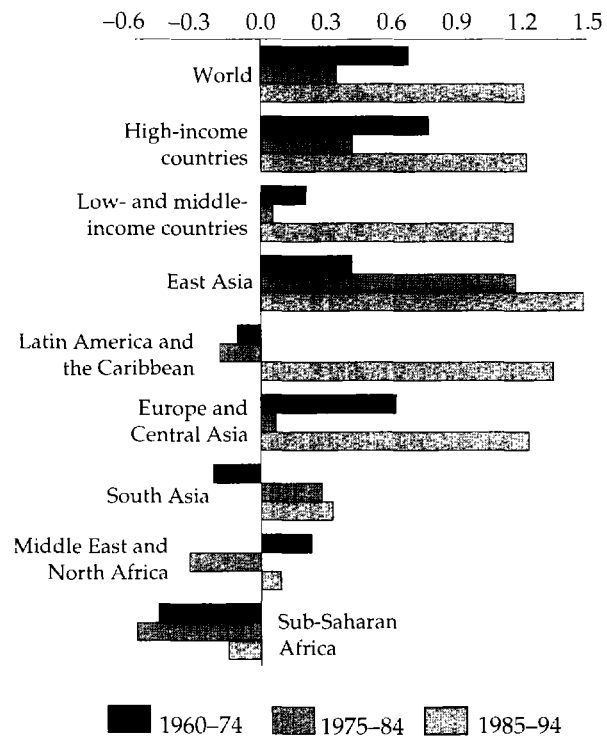
■ 1960–74   ▨ 1975–84   ▦ 1985–94

Source: World Bank data and staff estimates.

Figure 2-2 Average unweighted tariff rates for selected developing regions, 1985–93

Percent
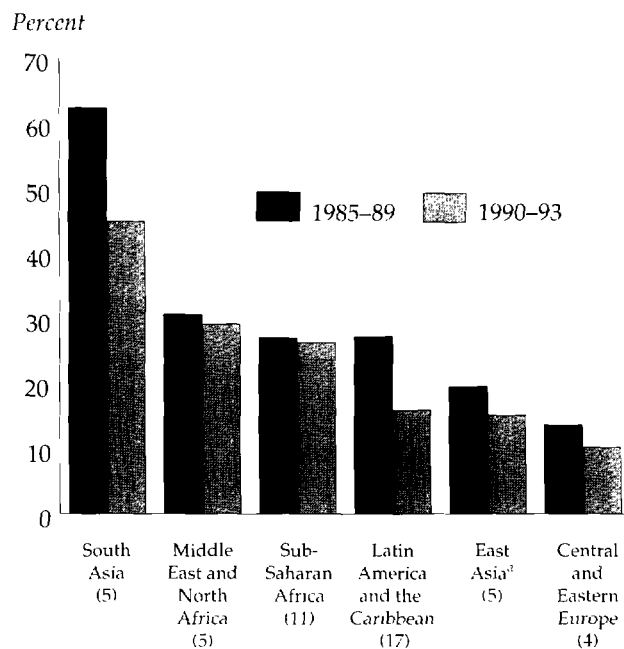
Note: Number of countries in parentheses.
a. Excludes China.
Source: World Bank data and staff estimates.

Figure 2-3 Foreign direct investment flows/GDP, 1981–93

Percent

Source: World Bank data and staff estimates.

tions, are a main source of distortion between domestic and international prices, resulting in resource misallocations and a reduced competitive spur from imports.[5] High levels of protection in particular can seriously impair growth. Despite the trend toward trade liberalization in developing countries over the past decade, there are still large differences in the extent of liberalization undertaken and the levels of protection remaining. Tariffs in South Asia, averaging around 45 percent in the early 1990s, remain far higher than in other regions, while those in the Middle East and North Africa and Sub-Saharan Africa, both in the 25–30 percent range, have shown little change since the second half of the 1980s. However, several transition economies in Central and Eastern Europe have achieved average tariffs of about 10 percent, while rates in Latin America and East Asia (excluding China) are down to around 15 percent. Tariffs in industrial countries on imports from developing countries are now down to about 4 percent.

The distribution of FDI across developing countries is also highly skewed (figure 2-3). Eight countries that account for 30 percent of developing country GDP garnered two-thirds of overall FDI flows in 1990–93. For half of the ninety-three developing countries reviewed

FDI inflows were less than 0.25 percent of GDP in 1991–93. Regions with particularly low ratios of FDI to GDP included South Asia, Sub-Saharan Africa, and the Middle East and North Africa. Over the past decade ratios of FDI to GDP fell in thirty-seven of the ninety-three countries studied. Of these, twenty were in Sub-Saharan Africa, nine were in Latin America and the Caribbean, and seven were in the Middle East and North Africa. In many cases these falls reflected a loss of country creditworthiness due to macroeconomic instability, adverse terms of trade shocks, political uncertainties, and civil strife. The large increase in FDI in high-income countries, together with a substantial rise in their trade ratios, underscores the fact that these countries, already the most integrated, are continuing to deepen their interaction with the world economy. As with trade, FDI is a significant indicator of integration in part because of its potential for diffusing technology and skills (box 2-2).[6]

Two other indicators that shed light on disparities in integration are country credit ratings and the share of manufactures in exports. Credit ratings are a measure of both access to private capital markets and the terms of that access; the share of manufactures in exports measures exposure to international technolo-

Box 2-2 The success story of India's Maruti Udyog

The 1982 establishment of Maruti Udyog Limited (MUL), a joint venture between the government of India and Suzuki Motor Company of Japan, was a watershed in the development of the Indian automobile industry. Since then, car sales have soared 16 percent a year, with MUL selling more units in its first five years of operation than all other domestic manufacturers combined in the previous forty years. Productivity levels have reached nearly fifty-three cars per employee per year, compared with five for the next big Indian producer and twenty-three cars or trucks for General Motors, the biggest producer in North America, and are still rising. The company produces nearly three-quarters of the passenger cars in India and has entered foreign markets, with about 10 percent of production exported.

MUL's presence also has generated significant spillover benefits for Indian industry, particularly the auto components sector. A recent study of Asian auto markets found that the company's strict quality standards and close collaboration with vendors have "changed the market's perception of design and quality and revolutionized the components industry through its philosophy of vendor upgradation" (Maxton 1994). MUL actively nurtured some critical component industries by establishing eleven joint venture companies to help push quality and productivity concerns upstream. As a result about 75 percent of components are now sourced from domestic suppliers, with the rest manufactured in-house or imported. The local content of MUL's most popular model is now 95 percent.

The improvements spawned by MUL have supported 22 percent annual growth in the components industry since 1986 and led to the industry achieving $2 billion in output and $300 million in exports in 1995. Though most exports are replacement parts for older models in industrial countries, supplies to original equipment manufacturers are on the rise. For instance, Sundram Fasteners, a company in Madras, supplies 85 percent of General Motors' need for radiator caps in the U.S. market.

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gies, although it also reflects the stage of development and factor endowments.

Country credit ratings generated by banks or rating agencies show wide disparities across developing countries, with many countries completely shut out of medium- and long-term private markets.[7] *Institutional Investor's* recent ratings for 126 countries are summarized in table 2-1. For the purposes of this table the ratings are divided into four equal ranges labeled, from best to worst, A through D. Such ratings are an important influence on the cost of funds in international markets. Countries with A ratings typi-

cally borrow at rates that are 50 basis points or less above benchmark U.S. rates. Borrowing costs rise as ratings fall, with many countries with C ratings paying 500 or more basis points over the benchmark, while most in the D category have no access to private lending. Highly rated countries can also borrow more relative to their economic size, and for longer maturities.

More than 40 percent of the countries in table 2-1 were in the lowest rating category. These include half or more of the countries in Sub-Saharan Africa, Latin America (chiefly in Central America and the Caribbean), and Europe and Central Asia (almost all states of the former Soviet Union). They also include nearly half the countries in the Middle East and North Africa, as well as Bangladesh, the Democratic People's Republic of Korea, Myanmar, Nepal, and Vietnam in Asia. The countries in the C category broadly comprise economies undertaking reforms whose payoffs still lie mainly in the future, including Argentina, Brazil, Colombia, and Mexico in Latin America, Morocco and Tunisia in the Middle East, India and Pakistan in South Asia, Hungary, Poland, and Turkey in Europe, and Botswana, Ghana, and Mauritius in Africa. While the highest-rated segment comprises exclusively high-income countries, the B category contains the most successful developing country exporters (Chile, China, Republic of Korea, Malaysia, and Thailand), as well as a number of Gulf countries with strong oil collateral.

The share of manufactures in exports may provide some information on countries' access to learning and technology transfer gains and ability to produce at world standards.[8] This ratio varies a great deal: two-thirds of the ninety-three developing countries

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Few developing countries have good access to private capital markets

Table 2-1 Country credit ratings, March 1995

Region	Credit rating				
	A	B	C	D	Total
High-income countries	19	7	1		27
East Asia		5	2	3	10
South Asia			3	2	5
Latin America and the Caribbean		1	10	13	24
Middle East and North Africa		4	4	6	14
Sub-Saharan Africa			6	19	25
Europe and Central Asia		3	7	11	21
Total	19	20	33	54	126

Source: Institutional Investor, March 1995.

reviewed had a share of manufactures in exports of a third or less in 1983–92, while half stood at less than 20 percent. Sub-Saharan Africa's share of manufactures in exports was less than 10 percent, while the Middle East and North Africa and Latin America and the Caribbean had average shares of 20–25 percent (figure 2-4). These regions also experienced the lowest rate of growth in shares of manufactured exports over the past ten years; shares fell in fourteen of thirty-six Sub-Saharan African countries.

A summary view of disparities

The foregoing discussion suggests that integration has a number of different dimensions and that a variety of indicators can be used to evaluate overall trends. To summarize integration trends, the analysis that follows uses a speed of integration index derived from changes between the early 1980s and early 1990s in four of the indicators discussed above: the ratio of real trade to GDP, the ratio of FDI to GDP, *Institutional Investor* credit ratings, and the share of manufactures in exports.[9] The speed of integration index is the simple average of changes in the four indicators over the period expressed as standardized scores.[10]

Manufactures exports are an important component of integrated economies

Figure 2-4 Average share of manufactures in merchandise exports, 1973–92

Percent
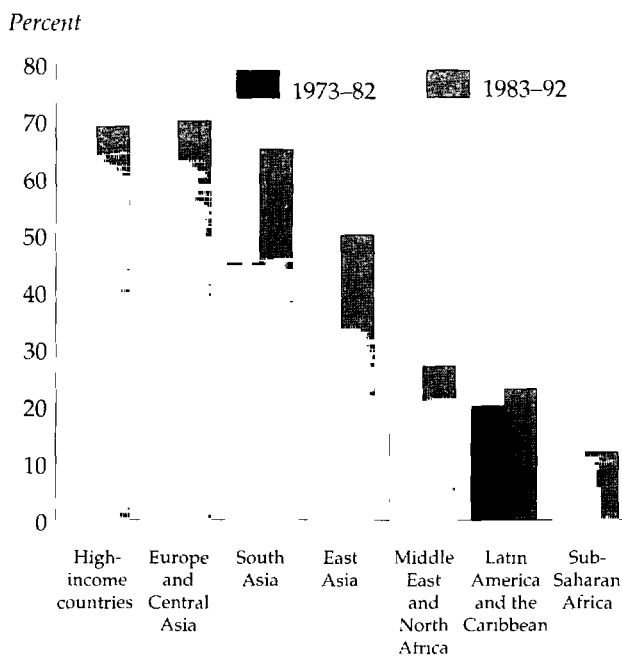
Source: World Bank data and staff estimates.

On the basis of this index, developing countries are grouped in four categories ranging from "fast integrators" (those with the highest index values) to "slow integrators" (those with the lowest; table 2-2). This classification is not intended to derive a precise categorization of individual countries but rather to develop evidence about the factors that might account for large differences in the speed of integration among groups of countries, and the consequences of this for performance. The complexity and variety of factors that affect the pace of integration of individual countries require detailed treatment for each country, something beyond the scope of this report.

There are striking disparities in developing countries' speeds of integration. Most of the fast-growing East Asian exporters were among the fast integrators as a result of exceptionally large increases in trade, manufactures exports, and FDI ratios. This group also contained reformers such as Argentina, Chile, and Mexico in Latin America, Morocco in the Middle East, Ghana and Mauritius in Sub-Saharan Africa, and the Czech Republic, Hungary, Poland, and Turkey in Europe. The concentration of transition economies in this and the next category of moderate integrators results from the marked rise in these countries' trade shares, FDI inflows, and credit ratings after the fall of communism.[11]

Among the anomalies that an index of this nature inevitably generates is that China falls into the group of weak integrators. The main reason is a reduction in its *Institutional Investor* credit rating, though the level of its credit rating remains among the highest given to developing countries. Since the credit rating component of the index differs from the other three components in being a summary of capital market judgments at a point in time (rather than a direct measure of flows), it is of interest to know how the index would appear without the credit rating component. On that basis, the broad analysis and conclusions remain unchanged, but many individual countries fall into a different quartile, notably China, which moves up to near the top of the group of moderate integrators, and India, which rises to the group of fast integrators. Another instance is Saudi Arabia, which was one of the strongest integrators at the start of the 1980s. Over the past ten years its speed of integration index was negative, reflecting falls in FDI consequent on reduced infrastructure needs and a drop in its very high rating in *Institutional Investor*. Yet Saudi Arabia remained one of the stronger integrators in the 1990s. In any event, the purpose of the analysis is not to rank countries but to draw broad conclusions about integration, growth, and policies (see appendix 2).

South Asian countries were concentrated in the fast or moderate integrator categories but retain considerable potential for furthering integration. Bangladesh,

India, and Pakistan had average tariffs in the early 1990s of 50 percent or more. Among other Asian countries, China had average tariffs around 40 percent. Nontariff barriers in some of these countries were also high. Similarly, Tunisia (a moderate integrator) had average tariffs in the 20–30 percent range. For all countries, lowering tariffs facilitates integration.

The weak and slow integrators in table 2-2 include not only most of the low-income countries in Sub-Saharan Africa but also many middle-income countries in Latin America and the Middle East and North Africa. Median trade ratios and credit ratings in Sub-Saharan Africa and the Middle East and North Africa fell, while median FDI ratios either fell or were stagnant. The countries in these categories also experienced much greater macroeconomic instability than other countries (see below). Many suffered substantial terms of trade declines over the past decade because of falling primary commodity prices. Finally, many are or have been subject to severe internal or external political conflicts and weak institutional development.

Integration and growth

Using the integration indicators discussed in the previous section, figure 2-5a documents the empirical association between faster speeds of integration and higher growth. The high-income countries and fast integrators among the developing countries achieved median per capita GDP growth of about 2 percent a year over the past decade. Moreover, the experience of the fast integrators was not merely a reflection of high-growth East Asian countries, although they are important. Excluding East Asian countries, fast integrators still achieved median per capita growth of 1.5 percent a year, well above the other classes of integrators. Median incomes fell among the other groups of integrators, with the largest declines occurring among

the weak and slow groups.[12] There was also a strong association between growth in 1984–93 and the level of integration prevailing at the beginning of the period (figure 2-5b).[13]

Per capita growth rates based on each of the four constituent integration variables are shown in table 2-3. Broadly speaking, the association between growth and the composite speed of integration index extends to each of these individual constituents, although the correlations are far from perfect.

For the most part, only fast-integrating developing countries saw per capita incomes converge toward industrial country levels over the past decade. In seventy-five of ninety-three developing countries—most of them in the slower integration categories—per capita GDP growth in 1984–93 was less than the 2.0 percent median of high-income countries, and in fifty countries per capita income levels fell over the decade. Finally, countries with better integration performance enjoyed not only higher but also more stable growth: the median standard deviation of per capita GDP growth among fast integrators was a little over half as high as among the weak and slow integrators.[14]

A number of interesting contrasts between the speed of integration and growth reflect the influence of factors other than integration on growth. Many transition economies in Central and Eastern Europe (Poland, the Czech Republic) integrated rapidly after the fall of communism even though output fell sharply during the adjustment to a market system. Mexico achieved a high integration speed over the past decade, but a combination of inadequate domestic savings, real exchange rate appreciation, and rising external deficits contributed to slowing growth in the early 1990s.

It is also important to note that there is a significant positive association between income and integration *levels*—that is, poor countries tend to have the lowest trade ratios (after adjusting for size), less FDI, lower

Developing countries show wide disparities in their speed of integration

Table 2-2 Speed of integration of developing countries, early 1980s to early 1990s
(number of countries)

Ranking	East Asia	South Asia	Latin America and the Caribbean	Middle East and North Africa	Sub-Saharan Africa	Europe and Central Asia
Fast integrators	6	3	5	2	2	5
Moderate integrators		2	5	4	10	2
Weak integrators	3		9	2	10	
Slow integrators			2	5	14	2
Total	9	5	21	13	36	9

Source: World Bank staff estimates.

Figure 2-5a Median real per capita GDP growth and speed of integration, 1984–93

Percent
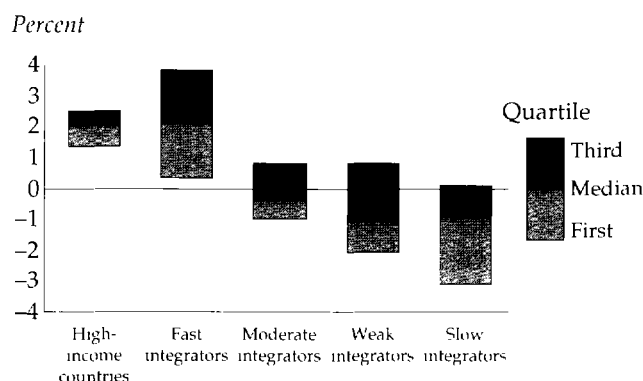
Figure 2-5b Median real per capita GDP growth, 1984–93, and initial level of integration, 1981–83

Percent
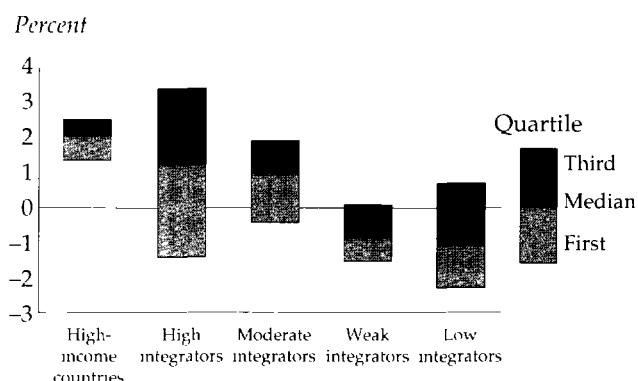
Source: World Bank data and staff estimates.

credit ratings, and lower shares of manufactures exports. But even though they start out with low levels of integration, poor countries are not necessarily slow integrators, just as they are not necessarily doomed to slow growth. In fact, the association between the speed of integration and the level of initial per capita income in 1981–83 is weak. Fast-integrating developing countries had a substantially higher speed of integration than high-income countries even though their per capita income levels were less than a third as high. Some large low-income countries such as India and Indonesia were among the fast and moderate integrators. And, conversely, high- and middle-income countries did not necessarily achieve a fast rate of integration.

The positive effect of freer trade and foreign investment on growth is undoubtedly one of the most critical factors explaining the relation between integration and growth. Simply put, factors such as technology transfer

and learning, improved resource allocation, greater competition, and access to foreign capital help countries grow. But this is only one part of the interaction between integration and growth. Growth itself tends to promote integration. Imports rise faster than incomes as consumers satisfy their desire for diversity. The rising returns to capital associated with faster growth raise developing country capital goods imports. Fast-growing countries attract more FDI and obtain better credit terms. As noted in chapter 1, East Asia most clearly illustrates how rapid growth tends to project countries onto regional and world markets while lack of growth, as in Sub-Saharan Africa, leads to marginalization in world goods and capital markets.[15]

The close association between growth and the speed of integration also suggests that both are likely to be affected by a number of common factors, including changes in the external environment,[16] the evolu-

Individual indicators of fast rates of integration are associated with high growth

Table 2-3 Real per capita GDP growth sorted by individual integration variable, 1984–93

(percent)

		Developing countries			
Variable	High-income countries	Fast integrators	Moderate integrators	Weak integrators	Slow integrators
Composite index	2.03	2.09	−0.40	−1.04	−0.92
Trade/GDP	2.03	−0.36	0.01	−0.12	−0.92
FDI/GDP	2.03	1.15	−0.67	−0.57	−0.84
Country credit rating	2.03	1.52	−0.67	−0.67	−0.36
Manufactures/exports	2.03	1.45	0.63	−0.67	−0.93

Source: World Bank staff estimates.

tion of the institutional setting,[17] and the policies pursued by governments. Policies that are good for growth are also apt to be good for integration, though some aspects of policy will have particular relevance for integration. The next section focuses on the critical role of such policies, the variable that governments have the most control over.

Policy reforms and integration

Policy reforms designed to increase growth and stability are likely to influence a country's speed of integration both directly and through their effect on growth, which, as noted above, also helps promote integration. Three types of policies affect the speed of integration relatively quickly: those relating to macroeconomic policy, trade and FDI regimes, and telecommunications and transport infrastructure.

Macroeconomic policy affects integration either directly, or indirectly through its effect on growth. Poor macroeconomic policies may affect integration directly, for example, through the impact of macroeconomic instability on FDI, other foreign capital inflows, and investment in the export sector of the

economy. Macroeconomic volatility deriving in large part from poor macroeconomic policies is estimated to have reduced Latin America's investment rate in 1960–85 by 5 percentage points of GDP relative to what it would have been had the region experienced the same volatility as industrial countries (Hausman and Gavin 1995). Macroeconomic volatility is estimated to have reduced developing country growth in 1960–90 by as much as 0.9 percentage point a year. (Schmidt-Hebbel 1995).[18] Volatility is especially likely to discourage foreign investors, who know less about the country than domestic investors, have greater choice in pursuing alternate opportunities outside the country, and are likely to attach a higher risk premium to a more unstable economy.[19] A volatile real exchange rate, one manifestation of macroeconomic instability, has been found to be a deterrent to investment in the export sector. The inverse empirical relationships between the volatility of exchange rates (adjusted for inflation) and ratios of trade to GDP and FDI to GDP (adjusted for population) are shown in figures 2-6a and 2-6b.[20]

It is empirically the case that countries that suffer from higher macroeconomic instability tend to be

A volatile exchange rate discourages trade and foreign investment

Figure 2-6a Real exchange rate volatility and population-adjusted trade/GDP

Percent

Real exchange rate volatility, 1984–93
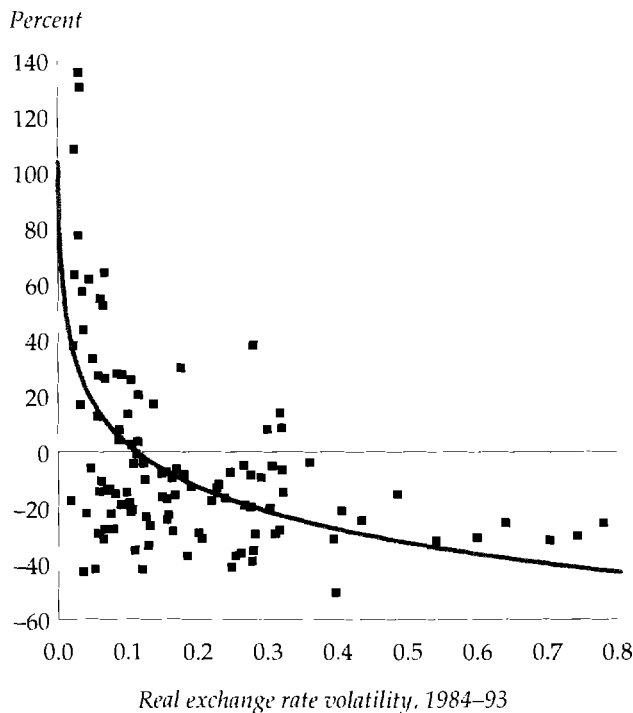
Figure 2-6b Real exchange rate volatility and foreign direct investment /GDP, 1991–93

Percent

Real exchange rate volatility, 1984–93
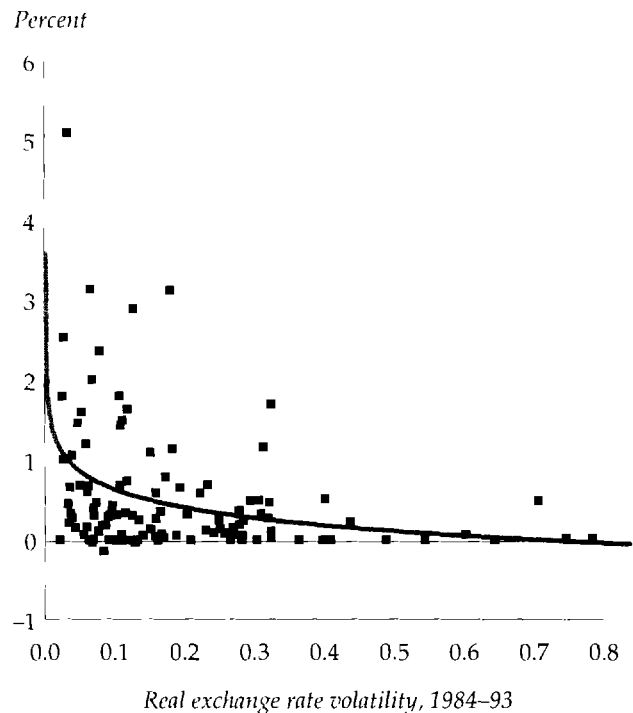
Source: World Bank data and staff estimates.

slower integrators (table 2-4). Median inflation rates were 7–11 percentage points lower in fast than in weak and slow integrators in 1984–93. Inflation volatility was also much lower among fast integrators. Median real exchange rate volatility among fast integrators was a third the level in slow integrators. Large fiscal deficits are the most important source of macroeconomic instability.[21] Slower integrators tend to have higher and more volatile deficits and to shrink their deficits at a slower rate (indeed, the deficits of the slowest integrators actually expanded during the 1980s). Large fiscal deficits can also affect integration in other ways, particularly when they are externally financed, by underpinning real exchange rate appreciation, which impedes integration by favoring nontradables over tradables, deterring exporters and foreign investors, and encouraging capital flight.[22] Investors, both foreign and domestic, demand macroeconomic stability. A final reason for the association between macroeconomic stability and integration is that countries undertaking stabilization after severe macroeconomic crises often use the opportunity to open their economies because it is easier to gain political support to do so.

Restrictive *trade and FDI policies* limit integration by restricting imports and inhibiting capital inflows. Protection also reduces the profitability of exporting relative to serving the domestic market and blunts incentives to adopt international standards of product quality and process efficiency. Because many foreign investors operate complex international supply networks, protection and its associated red tape reduces a country's attractiveness in these networks. In some developing countries (for example, China, Malaysia, and Hungary in recent years) foreign direct investors account for a large share of exports. As tariffs rise, countries tend to have a lower ratio of trade to GDP, even adjusting for the tendency of big economies to have small ratios (figure 2-7).[23] Using estimates by Sachs and Warner (1995a) of when countries achieved open policy regimes, we find a statistically significant increase in countries' speed of integration in the five years after opening compared with the five years before it. The increase in speed derives from more rapid gains in ratios of trade to GDP and better credit ratings. Trade liberalization is discussed at greater length in chapter 3.

The third policy area affecting the pace of integration is the availability and proper maintenance of adequate economic infrastructure, in particular telecommunications and transport facilities. High-quality communications are essential for countries that aim to participate in the globalized production structures established by multinational corporations, to respond promptly to rapidly changing market conditions in industrial countries, or to participate in new export markets for long-distance services such as data processing, software programming, back-office ser-

Macroeconomic instability undermines fast integration

Table 2-4 Integration policy and performance, 1984–93
(percent)

Performance indicator	High-income countries	Developing countries			
		Fast integrators	Moderate integrators	Weak integrators	Slow integrators
CPI inflation	3.63	13.40	16.86	23.86	19.89
Change in CPI inflation	–5.22	–2.81	–0.22	8.21	19.77
CPI inflation volatility[a]	1.65	7.24	7.63	14.21	13.27
Black market premium	0.00	0.12	0.56	0.41	0.48
Real exchange rate volatility[a]	0.06	0.13	0.20	0.27	0.40
GDP volatility[a]	1.89	2.61	3.09	4.39	3.60
Budget balance/GDP	–2.46	–2.37	–6.66	–3.70	–5.92
Change in budget deficit	1.16	1.88	0.79	0.38	–2.54
Budget balance volatility[a]	2.27	2.31	2.82	2.79	4.53

CPI is consumer price index.
Note: Contains data for eight-eight countries for which there were adequate tariff data. The balanced data set for this sample allows comparison across policy areas such as macroeconomic and trade policy. Values for integration classes are medians. Changes in inflation and budget deficit are between averages for 1981–83 and 1991–93. See appendix 3 for details on robustness of results.
a. Standard deviation.
Source: World Bank data and staff estimates.

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Figure 2-7 Average tariff rates and population-adjusted trade/GDP ratios

Trade ratio (percent)

Tariff rate (percent)
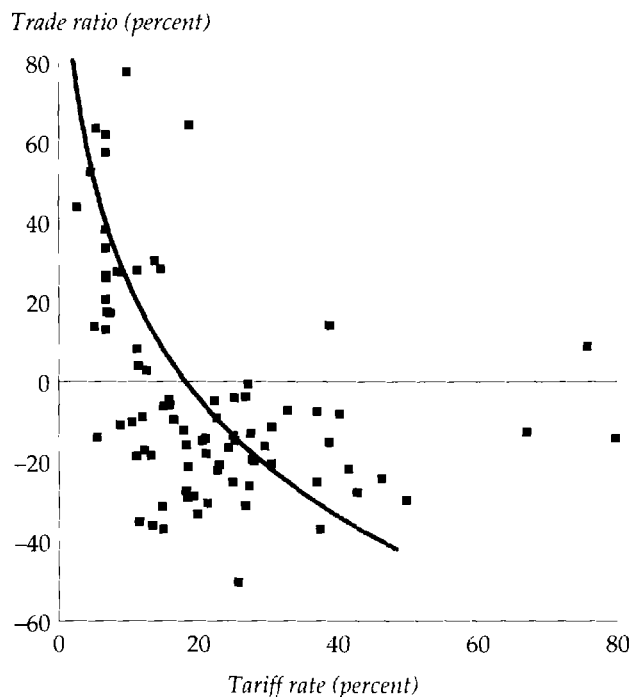
vices, and customer support (box 2-3; also see World Bank 1995b, chapter 3). As chapter 3 argues, high transport costs deriving in part from domestic policies are a serious impediment to African exports (Amjadi and Yeats 1995).

Prospects and risks for weak and slow integrators

Baseline projections for the next decade indicate a modest improvement in growth relative to the poor outcomes of the past decade (figure 2-8).[24] Median real per capita growth among weak and slow integrators is projected to rise to just over 1 percent a year in 1996–2005, compared with a –0.5 percent annual contraction in 1981–95. Median ratios of trade to GDP, which fell over the past decade, are expected to rise 0.5 percentage point a year in 1996–2005. But in the absence of accelerated reforms, this performance will be considerably less impressive than that of the fast and moderate integrators and high-income countries. One implication of these projections is that the absolute gap in per capita incomes between high-income countries and some three-quarters of developing countries will continue to rise. Further, the projected improvement in growth among the weak and slow integrators is subject to significant uncertainties.

The forty-seven countries in the group of weak and slow integrators (hereafter called the slower integrators) carry a significant economic weight among developing countries, accounting for about a quarter of GDP and a third of developing country population.[25] Of the forty-seven, twenty-seven were low-income countries, twenty-one of them in Sub-Saharan Africa. The twenty middle-income slower integrators were concentrated in Latin America and the Middle East and North Africa.

One reason to expect modestly better growth and integration performance are the partial efforts at economic reform undertaken by many countries and the likelihood that these efforts will continue. During the 1980s many countries in Sub-Saharan Africa made progress on reducing trade barriers (especially non-tariff barriers), foreign exchange controls, exchange rate overvaluation, and heavy taxation of exporters (especially farmers), while a smaller number also made progress on macroeconomic policies (World Bank 1994). Many slower integrators in Latin America, the Middle East and North Africa, and the transition economies made similar efforts at policy reform. A second reason is that, after an unwinding of their recent strength in the next year or two, real primary commodity prices are projected to be relatively flat compared with the 1980s and early 1990s, when sharp declines reduced slower integrators' terms of trade by 2 percent a year and impeded both growth and progress in integration.

Still, these factors are insufficient to prevent a continued decline in these countries' incomes and integration levels relative to high-income countries and fast-integrating developing countries. Despite some progress, macroeconomic, trade, infrastructure, public sector, and financial sector policies remain far from international standards. Even Africa's best performers have worse macroeconomic policies than Asia's newly industrialized economies (World Bank 1994). Despite trade reforms most African countries retain high and dispersed tariffs, and little progress has been made in reforming and reducing the size of swollen public sectors or in strengthening weak financial sectors. And while flat real commodity prices might not act as a major drag on growth and integration, they are also unlikely to provide a boost to performance in the coming decade. In addition, world import demand for primary commodities is projected to grow by only 3–4 percent a year compared with more than 6 percent for merchandise volumes as a whole.

Competition in commodity markets (from efficient producers like Chile and Malaysia) and manufactures markets (from low-income exporters like India and China) will remain fierce. Given their overwhelming abundance of labor relative to other factors of production and assuming continued reforms, China and India will likely retain their comparative advantage in

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Box 2-3 Telecommunications growth in developing economies

Telecommunications forms an indispensable part of the infrastructure of a modern economy, providing the means to both transmit and process information. As information continues to grow in importance as a factor of production—one estimate suggests that by 2000 70 percent of OECD employment will be information-related—the demand for telecommunications services is rising fast. Developing countries have increasingly recognized that a high-quality telecommunications infrastructure is essential to compete successfully in the global marketplace.

Telephone density, defined as the number of main lines per 100 people, varies widely across countries. In high-income countries telephone density ranges from 40 to 60 percent, whereas in developing countries it is less than 20 percent, ranging from 16 percent in Russia to less than 0.2 percent in Uganda (box figure). Telephone density is significantly correlated with per capita GDP (World Bank 1995c). Some countries, however, have achieved much higher telephone density than their per capita output might suggest (for example, Egypt and Poland), and some much lower (Côte d'Ivoire).

At the end of 1993 the global number of telephones totaled some 607 million, up more than 150 percent from ten years earlier. In the OECD countries, which represent about 15 percent of the world's population, telephone density rose from 39 percent to 49 percent. Growth in the rest of the world went from 2.1 to 3.5 percent. Among the regions, Sub-Saharan Africa had the third highest growth

rate in main lines, which was offset by higher population growth. The number of main lines also grew fast in Latin America (about 8 percent a year) and Asia, notably in the Republic of Korea, Singapore, and Taiwan (China).

One indicator of demand is the waiting period for installation of a telephone connection. In developing countries the average is 1.5 years; again, the figure varies widely across developing countries and in some instances exceeds 10 years (see box figure). With the advent of cellular radio, however, main lines do not tell the whole story. Globally, cellular lines grew by an average of 45 percent in 1990–93, making it one of the highest-growth industries. In many developing countries cellular lines are fast becoming a basic mode of provision, since they can be supplied rapidly to both urban and rural areas.

The level of international telephone tariffs is a primary determinant of the balance of telephone traffic between countries. Thus they can significantly influence the degree to which a country can participate in international business. Some developing countries follow distortionary policies, maintaining high collection charges to discourage outgoing calls and hence earn a foreign exchange surplus. For example, the charge for a one-minute telephone call from Tanzania to the United States is about $7.50 equivalent, whereas the charge for the same call in the reverse direction, from the United States to Tanzania, averages about $2.

Telephone coverage is still spotty in many developing countries

Telephone density and waiting period for selected countries, 1993

Main lines per 100 residents

Waiting period
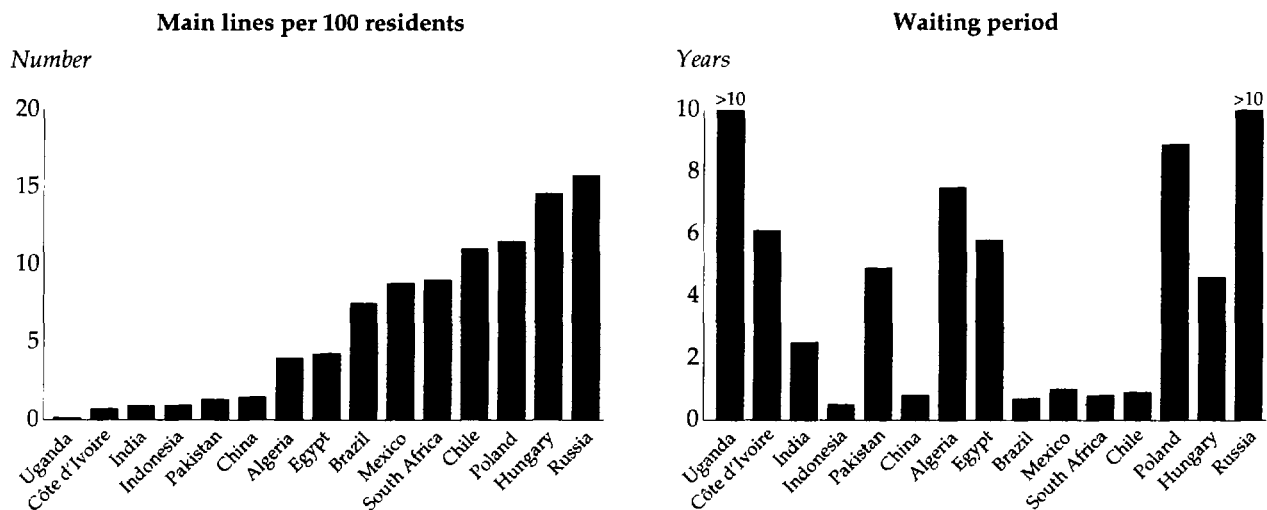
labor-intensive manufactures for some time, especially given these countries' large income disparities between regions and between urban and rural populations.[26] Slower integrators are likely to face intense competition as they try to establish footholds in these markets and to some extent will be forced to focus on niche manufactures markets that are based on unique or specialized factors or skills.

Figure 2-8 Median real per capita GDP growth by integration category, 1971–2005

Percent
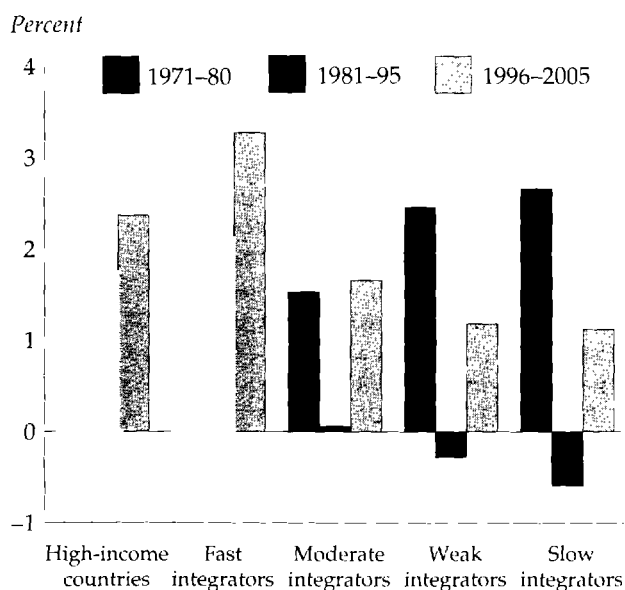
Source: World Bank data and staff projections.

Fast growth in China and India will, of course, also generate markets for capital- and technology-intensive products on the one hand and for land- and natural-resource intensive products on the other. Products based on land and natural resources may provide new export markets for the slower integrators if they are nimble and efficient enough to take advantage of them. Exploiting these opportunities will require upgrading from raw material exports to higher value added, natural resource–based manufactures and facing up to competition from fast integrators with flourishing primary commodity sectors like Chile, Indonesia, Malaysia, and Thailand.

The pressures on slower integrators' export markets may also be aggravated by constraints on other sources of foreign exchange. As chapter 1 noted, the growth of foreign aid, a major source of foreign transfers in many slower integrators, is likely to slow. Worker remittances inflows may also be sluggish as a result of flat demand in labor-importing oil producers, a shift in demand toward more highly skilled migrant workers, and tighter immigration controls in many industrial countries suffering from high unemployment.

It is also worth stressing the fragility of even the modest baseline assessment of the slower integrators' prospects, which assumes a relatively favorable international economic environment. Primary commodity prices are expected to decline less steeply than in the

past decade, world trade is expected to grow briskly, and private financial flows to developing countries are expected to be significant, albeit selective. Each of these assumptions is subject to significant risk, as discussed earlier in chapter 1.

Still, the baseline projections should not be a cause for despair. The experience of fast-integrating developing countries provides powerful, practical lessons for countries that want to expand their engagement with the world economy in order to enhance their growth performance. After all, some of today's fast integrators were yesterday's weak performers. These issues are taken up in chapters 3 and 4.

Notes

1. Migration of labor, one significant dimension of integration, is not addressed in this report. For a recent extensive discussion see World Bank (1995d).

2. The trade ratio is defined as exports plus imports of goods and nonfactor services in real terms as a percentage of real GDP.

3. The analysis excludes countries with inadequate data, including many small (often island) economies and certain current or formerly socialist countries, including Cambodia, the Democratic People's Republic of Korea, Vietnam, and the countries emerging from the former Soviet Union.

4. Other recent studies of the role of trade as a channel of technology transfer include Pack and Page (1994).

5. Easterly (1993) finds that a one standard deviation increase in distortions of input prices relative to world prices was associated with 1.2 percentage point lower per capita GDP growth in 1970–85. Levinsohn (1993) and Harrison (1994) discuss evidence for the "imports as market discipline" hypothesis.

6. Borensztein, de Gregorio, and Lee (1995) find that a one percentage point increase in the ratio of FDI to GDP in developing countries in 1971–89 was associated with 0.4–0.7 percentage point higher per capita GDP growth. The impact varied positively with educational attainment, an indicator of a country's ability to absorb technology.

7. Properties of these ratings and their relationship with underlying economic performance are discussed in Haque and others (1995). Formal measures of financial integration include interest rate differentials, savings-investment correlations, and consumption tests; see Montiel (1993).

8. Sachs and Warner (1995b) find that a 10 percentage point higher share of manufactures in exports is associated with 0.3 percentage point higher per capita GDP growth (after accounting for other influences on growth such as investment and education).

9. The analysis focuses on changes in rather than on level of integration for two reasons. First, the acceleration of globalization over the past decade makes the question of changes and their trends of inherent interest. Second, mea-

sures of the level of integration such as the trade ratio are heavily influenced by the size of the economy, the abundance of its natural resources, and other structural factors, which is not the case for the speed of integration. As it turns out, the distinction between levels and rates of change may be less important than it first appears because, as shown in figure 2-5a and 2-5b and discussed in appendix 3, the main conclusions of the analysis hold whether speeds or levels of integration are used. The indicators also refer to integration outcomes rather than to policies affecting integration. Keeping policies and outcomes separate allows for later evaluation of the association between them.

10. The standardized score is the variable, less its mean, divided by its standard deviation. The resulting standard variable has a mean of zero and a standard deviation of one. This procedure prevents the composite index from being dominated by constituents with the highest volatility. Appendix tables A2.1 and A2.2 present underlying data for these countries and for twenty-three high-income countries.

11. Rising trade shares in these economies were due in part to the fall in their output in the early 1990s. But it remains true that a larger share of their (smaller) output is internationally traded and that they are more closely integrated with the world economy than before.

12. In a regression for 115 countries of per capita growth on the speed of integration index, which is measured in standard deviations, the regression coefficient is 2.6 with a t statistic of more than 6. The correlation coefficient between the two variables is about 0.5.

13. This association between the level of initial integration and growth is consistent with studies finding growth to be positively associated with open policy regimes (Sachs and Warner 1995a; Ben-David 1993). The index for the level of integration is constructed as the simple average of the four constituent variables (trade-GDP ratio, FDI-GDP ratio, country credit rating, share of manufactures in exports) expressed as standardized scores. Developing countries are then classified as high, moderate, weak, or low integrators. Trade ratios are adjusted for the systematic influence of country size by using the residuals from a regression of trade ratios on population: bigger countries tend to trade less proportionately. China, which had a low score on the speed of integration index, has among the highest scores on the level of integration index. Appendix table A2.2 presents underlying data for the initial level of integration.

14. Recent evidence supports the contention that countries with more open trade and investment policies also grow faster. Sachs and Warner (1995a) find that, after controlling for other influences on growth such as education and investment, countries with open policy regimes in 1971–89 had average per capita GDP growth that was 2.5 percentage points a year higher than countries with closed regimes. They were also less prone to macroeconomic crises, defined as rescheduling of foreign debt, arrears on external payments, or inflation greater than 100 percent. (Open policy regimes were defined in relation to tariffs, quotas, black market premiums, export marketing monopolies, and the existence of a socialist economic system).

15. In this vein Rodrik (1995) argues that rapid trade integration in the Republic of Korea and Taiwan (China) initially resulted from government policies in the 1960s that raised returns to capital and generated a domestic investment boom, which raised demand for capital goods that neither country had a comparative advantage in producing. The resulting faster import growth necessitated faster export growth, which was facilitated by appropriate macroeconomic and exchange rate policies.

16. Slow integrators suffered median terms of trade declines that were more than 2 percentage points a year larger than the fast integrators in 1984–93. Note, however, that these differences could account for income losses of perhaps 0.5 percentage point a year (assuming import to GDP ratios of 20 percent), compared with a gap in GDP growth between the two groups of more than 3 percentage points a year.

17. Survey data indicates that FDI in Sub-Saharan African countries, most of which were poor performers, was especially affected by the possibility of extreme events (civil war, expropriation), high uncertainty about policies, and the lack of adequate restraint mechanisms on the arbitrary exercise of power. (See Collier 1995a on these and other institutional factors in the marginalization of Africa). Though difficult to measure, the quality of institutional development is likely to be important for both growth and integration. Institutions promote domestic and foreign trade and investment by reducing the transaction costs of economic activity, such as the costs of contracting, protecting property rights, obtaining information, and dealing with uncertainty (North 1991). Foreign investors and traders are likely to be especially sensitive to these considerations.

18. The effects of uncertainty on investment when investments are irreversible are analyzed by Dixit and Pindyck (1994). Leahy and Whited (1995), Pindyck and Solimano (1994), and Fischer (1993) provide empirical evidence for the adverse impact of volatility on investment, productivity, and output growth.

19. Thus lower domestic investment is associated with lower FDI (Edwards 1990). Credit ratings, a measure of access to other types of foreign capital, are also adversely affected by elements of macroeconomic instability such as inflation, external indebtedness, and current account deficits (Haque and others 1995).

20. Caballero and Corbo (1989) find that higher real exchange rate volatility is associated with less export growth. Roberts, Sullivan, and Tybout (1995) find a similar result for a panel of firms from Columbia, Mexico, and Morocco and argue that volatility discourages the sunk-cost investments needed to export. The strength of the relationships between tariffs and real exchange rate volatility on the one hand and the ratios in figures 2.6a and 2.6b might be overstated if there was a strong association between the first two factors. That is unlikely because the correlation between the two in this sample is only 0.15.

21. Schmidt-Hebbel (1995) finds a strong association between fiscal deficits and a measure of central bank independence on the one hand and an index of macroeconomic instability based on inflation, the volatility of the real exchange rate, the ratio of external debt to GDP, and the black market premium on the other.

22. Macroeconomic stability variables retain a significant association with the separate constituent speed of integration variables in a significant number of cases.

23. Population-adjusted trade ratios, which attempt to purge the systematic influence of country size on trade ratios, are the residuals from a regression of trade ratios on population. Lee (1992) also documents the strong inverse relation of trade restrictions to trade integration.

24. These projections are a subset of the standard projections summarized in chapter 1.

25. To emphasize the importance of the group of slower integrators this calculation excludes China, which would dominate GDP and population totals on its own. See earlier comments and appendix 1 for more details on the position of China.

26. China and India's combined labor force of 1.2 billion people is three times that of the slower integrators (excluding China), while their ratios of labor to arable land are higher than those in 90 percent of the slower integrators.

2

Obstacles and opportunities
on the path to trade integration

International trade is the main engine driving global economic integration. In the aftermath of the Uruguay Round the volume of trade continues to grow at a brisk pace, more than twice that of world output. Tariffs are at new lows, averaging just under 4 percent in industrial countries. Services, which account for roughly one-third of world trade (half traded services and half investment and factor incomes), are now subject to multilateral disciplines, albeit weak ones. A start has been made on establishing global intellectual property rights. And countries in transition, representing about a quarter of the world's population (including China), are progressively becoming part of the world economy. Over the past decade developing countries have reduced tariffs, notably in Latin America (from an average of 27 percent to 15 percent) and South Asia (from more than 60 percent to about 45 percent). Besides changing attitudes toward trade policy, an important impetus to growth has come from the continued fall in the costs of trade, especially communications costs. Thus it is no exaggeration to say that world trade at the end of the twentieth century is as healthy as at any time in the postwar era.

Many developing countries have lagged behind, however, in opening to world trade, as discussed in chapter 2. Policymakers in developing countries are often deterred by perceptions of trade barriers and the uncertain benefits and apparently certain costs of liberalization. This hesitation often feeds back to gradualism and timidity in pursuing reform. As a result the characteristic features of global integration are also found in trade: big disparities across developing countries, an associated divergence in growth and living standards, and a set of underlying policy deficiencies. This chapter looks behind these features to the issues with which the slow integrators in particular are grappling.

The gradual reformers are becoming more aware of lost opportunities and are contemplating measures to liberalize their trade regimes. The debate revolves around the desirable breadth and depth of trade reform and its pace and sequencing. These countries face three main issues. First, what are the costs of trade reform? Second, do world markets in fact offer a level playing field and, hence, what is the probability of reform being successful? Third, do regional trading arrangements provide a feasible alternative to multilateral or unilateral liberalization?

This chapter addresses these issues, particularly in light of the experience of successful reformers accumulated over the past ten years. The central message is that the adjustment costs of trade reform can be quite low if appropriate complementary policies are adopted, and that while genuine external impediments to successful liberalization do exist—and are sizable for some countries—some major obstacles are avoidable. The main conclusions are:

- Though we understand less than we should about the transition costs of liberalization, the case for opening domestic markets to imports (without favoring certain trading partners) has been strengthened by the record of the past ten years. While there are genuine transition costs to trade liberalization, these costs tend to be overestimated and can be minimized by appropriate complementary macroeconomic and regulatory reform.

- Important and real external obstacles to growth in trade remain, including the spread of antidumping practices, agricultural protection, and, for the time being, the Multifiber Arrangement. These are significant problems for some countries, so it is important for OECD countries to continue efforts to open markets in these areas. In addition, excessive transport costs remain a major handicap for some countries, especially in Sub-Saharan Africa.

- Regionalism is a sufficiently diverse and new phenomenon as to defy simple conclusions. But recent experience—notably, the growth of East Asian trade—suggests that it is neither a necessary nor a sufficient condition for successful integration with either the world or a regional economy. Nevertheless, preferential trading

arrangements between developing and industrial countries can carry important benefits for developing countries by securing markets, encouraging investment, and enhancing the discipline and credibility of reform. The benefits of trade arrangements between developing countries tend to be much smaller.

Minimizing the adjustment costs of trade reform

Trade experts know less than they would like to about the conditions required to secure the benefits of trade reform and about how to minimize the transition costs. Still, some important lessons have been learned. This section analyzes the main concerns and reviews how they have been addressed by successful reformers.

A first concern is that *the supply response to trade reform may vary from country to country and in some cases may be weak*. The trouble with assessing supply response—for instance, the volume of production and the alignment of relative prices to world prices—is that the evidence often gives rise to conflicting interpretations. In most cases, though, it is less an issue of whether trade reform works than an issue of whether it has been tried. The pace of reform is often slower than is sometimes claimed, for instance in Sub-Saharan Africa, where much agricultural reform only started around 1991, several years after other reforms. And when the supply response is poor, there is almost always a negative protection or regulatory barrier to explain it, such as cash crops that are heavily controlled by the buying power (monopsony) of state marketing boards.

A related issue concerns what complementary policies are necessary, for example, macroeconomic stabilization. Large fiscal deficits are probably the single most important reason for the collapse of trade reforms, followed by inflationary financing and overvalued real exchange rates. Since tariffs are often an important source of government revenue for developing countries, tax mobilization is an indispensable accompaniment to tariff reduction. Supply response also depends on the credibility of reforms. Ways to signal credibility include commitment to the World Trade Organization or to adjustment programs supported by multilateral institutions.

Assessments of supply response, then, first require a sorting out of facts about regulation and movements in incentives and relative prices. One study of Sub-Saharan Africa illustrates the importance of complementary policies (Collier 1995b). Collier proposes a set of conditions that constitute a "minimum adequate environment" for prospective reformers; countries that do not meet any of the criteria are deemed not to have established conditions satisfactory for growth. The conditions are absence of civil war, which excludes countries accounting for 11 percent of the

region's population; absence of macroeconomic stability, a further 40 percent; and absence of adequate resource allocation (a composite measure of trade and exchange rate regimes, financial sector depth, and public sector intrusiveness), a further 12 percent. An additional 8 percent of the population in middle-income countries is excluded, leaving 29 percent of Sub-Saharan countries with a minimum adequate environment necessary for growth. The countries in this category are in fact performing quite well, with annual growth of about 6 percent, contrasted with negative growth in the other low-income countries.

A second concern is that *trade reform can prove costly in terms of declining industrial sectors and higher unemployment*. Though it has proved difficult to isolate and measure this transition cost—because reforms often are accompanied by contractionary stabilization policies—the evidence suggests that there is no systematic connection between reform and unemployment or short-run growth. Indeed, unemployment in manufacturing increases about as often as it decreases (Harrison and Revenga 1995). An earlier study of eighteen trade reform episodes similarly concluded that no association can be established in individual countries between trade liberalization and short-run unemployment in the manufacturing sector (Papageorgiou, Michaely, and Choksi 1990).

How to explain these surprising findings? In part, by the capacity of new export-oriented firms to quickly enter the market and of existing firms to quickly switch production strategies toward exports (provided reforms are credible). This capacity has been underestimated because of the lack of data at a sufficiently disaggregated (that is, firm) level. Industry-level data miss the shifts that go on among firms within industries, which is where the vast majority of micro-level reallocation occurs.

A new study of micro-patterns of turnover, productivity, and market structure suggests that industrial evolution in developing countries is much more dynamic than previously thought (Roberts and Tybout forthcoming). Among the study's findings is that substantial job creation and destruction take place at all phases of the business cycle, implying that economies must continually adapt to changing circumstances, whether or not they open to trade.

These findings are in accord with the experience of Ghana following its trade reform of the mid-1980s (World Bank 1994). After the reforms were introduced, export-oriented firms expanded rapidly while import-substituting textile firms contracted. In some cases old export markets were revived, for example, in furniture, aluminum utensils, African prints, and milk. On balance the manufacturing sector's employment increased by some 10 percent a year between 1984 and 1991.

Nevertheless, the workings of factor markets may be slow, especially in countries that are the least integrated with the global economy. Leads and lags and the reallocation of resources from nontradables to tradables mean that governments have a role to play in removing impediments in these markets, in addressing social costs through targeted social safety net programs, and in managing the political economy of trade reform.

A third concern is that *trade liberalization can have an adverse impact on fiscal and current account balances*. Trade liberalization is motivated by concerns of efficiency and growth rather than macroeconomic balance. Nonetheless, although it reduces the cost of imports, it need not have an adverse impact on the budget balance or the balance of payments when accompanied by appropriate exchange rate and fiscal policies. To the contrary, a study of nine developing countries that received thirty-five trade-related adjustment loans during the 1980s suggests that output and exports can increase as a result of trade reform, improving fiscal and current account balances, provided that strong complementary fiscal measures are taken (table 3-1).

In six of the nine countries real GDP growth rates were higher after reform: intensive adjusters such as Ghana, Indonesia, Morocco, and Turkey were able to achieve high rates of growth. All the countries reduced quantitative restrictions on imports, and those that reduced tariffs experienced substantial increases in productivity. Most of the countries also engineered a substantial depreciation of the real

exchange rate (Côte d'Ivoire was the exception) and experienced a faster growth rate of exports. In this context of highly respectable output and trade performance, most of the countries were able to improve their fiscal and current account balances through complementary fiscal policies.

Since there are likely to be transition costs associated with the reallocation of labor and capital among industrial sectors following trade reform, and since these costs will affect categories of workers, regions, and sectors unevenly, managing this transition is one of the policy challenges posed by reform. Successful reformers have complemented trade liberalization with macroeconomic stability, including the control of fiscal deficits and inflation; avoidance of overvalued exchange rates, which often includes real exchange rate devaluation; adequate compensatory tax mechanisms where necessary; and efficient domestic resource allocation mechanisms, such as financial sector reform and a reduced role for parastatals. Poland's recent experience provides a good example of such efforts (box 3.1). Adopting appropriate complementary policies helps minimize the adjustment costs associated with trade liberalization and reduces the chances of a reversal.

Obstacles, both real and imagined, to trade integration

Another important concern of policymakers is that world markets in trade do not offer a level playing field,

Trade reform can be complemented by improved fiscal and current account policies

Table 3-1 Impact of trade reform for World Bank trade adjustment loan recipients, 1978–89
(percent)

Period[a]	Colombia	Côte d'Ivoire	Ghana	Indonesia	Jamaica	Mexico	Morocco	Pakistan	Turkey	Average
Real GDP growth rate										
Before	4.2	4.4	–0.2	5.8	–3.1	6.8	4.6	7.3	2.1	3.6
During	2.8	1.2	3.0	3.9	3.0	0.7	3.5	6.4	4.9	3.3
After	4.6	–1.7	5.4	7.7	3.2	0.5	4.9	6.3	5.1	4.0
Fiscal balance as a share of GDP										
Before	–3.6	–13.9	–9.4	–2.3	–13.5	–10.4	–11.4	–6.9	–7.0	–8.7
During	–5.8	–3.8	–2.2	–2.0	–14.4	–8.9	–9.8	–6.9	–6.1	–6.7
After	–1.3	–6.4	0.3	–3.2	–10.1	–12.6	–4.0	–7.8	–6.3	–5.7
Current account balance as a share of GDP										
Before	–5.9	–9.6	–2.1	–0.6	–8.0	–4.1	–10.4	–4.5	–3.1	–5.4
During	–7.8	–4.9	–2.7	–4.1	–13.3	2.2	–6.9	–3.5	–2.8	–4.9
After	0.3	–2.9	–2.9	–3.4	–1.4	–0.6	0.4	–3.5	–0.6	–1.6

a. Before refers to 1978–82, during to 1983–85, and after to 1986–89.
Source: World Bank data and staff estimates.

Box 3-1 How Poland sustained its trade turnaround, despite the costs

Poland's experience shows that trade reform in conjunction with macroeconomic stabilization does carry transition costs, but that with perseverance the benefits can be much greater than the costs. It also shows the importance of complementary reforms, such as privatization of state-owned enterprises.

Poland's "big bang" reform featured simultaneous stabilization, liberalization, and privatization, as well as the establishment of market-supporting institutions. On January 1, 1990, the prices of all exportables were liberalized, exchange rates were unified, the domestic currency became convertible (for current account transactions), a positive real interest rate was introduced, and wages in the public sector were frozen. More gradual complementary reforms in public finance, the banking sector, and state-owned enterprises, including privatization, were also announced.

Poland's output fell by more than 20 percent in 1990–91 but rebounded sharply with 2.5 percent growth in 1992, an average 4.6 percent in 1993–94, and an estimated 7 percent in 1995. Initially, unemployment—an unknown phenomenon under the command economy—started to emerge. The contraction in output was temporarily exacerbated by state-owned enterprises shedding input inventories and other assets. Polish trade underwent a rapid reorientation from members of the Council for Mutual Economic Assistance (CMEA) to members of the OECD. In 1990 alone the value of exports to OECD markets increased by 46 percent. The share of CMEA countries in total exports fell from 41 percent in 1989 to 13 percent in 1994, and by 1992 Germany had replaced the Soviet Union as Poland's major trading partner.

How did Poland manage to stay the macroeconomic course? Faced with sluggish exports in early 1991, the authorities moved from a pegged exchange rate linked to the U.S. dollar to a crawling exchange rate linked to a basket of currencies of Poland's major trading partners. Rigid monetary and interest rate policies discouraged the continuation of soft budget constraints, which in turn created incentives to shift production toward import substitutes and exportables. Privatization of initially successful state-owned enterprises locked in improved performance by insulating them from potential political pressures. The supply response was driven not by easily depletable energy products or raw materials, but by manufactures. The share of manufactures in total exports to OECD countries increased from 47 percent in 1988 to almost 70 percent in 1994. Opening of the economy to external competition produced adjustment in relative factor intensities more in line with factor endowments.

External factors were also important, especially improved access to EU markets. Generalized System of Preferences status and later the trade provisions (the Interim Trade Agreement) of an EU association agreement eliminated tariffs on some industrial products and gradually reduced tariffs on others. In 1992, the first year of the Interim Trade Agreement, about 60 percent of industrial exports obtained duty-free access to EU (then EC) markets. Thus, while the value of exports to the former Soviet Union fell by 78 percent over 1988–94, exports to the European Union increased by 355 percent. Foreign direct investment helped as well. Sales of the Fiat joint venture, Fiat Auto Poland, Inc., made it the sixth largest Polish exporter in 1993. In 1992 Fiat was not even among the 500 largest enterprises.

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making for a low probability of success in opening to trade. Developing countries' fear that global markets for goods and services are stacked against them helps explain why some (particularly in the Middle East, Africa, and Central America) have adopted a gradualist and overly cautious approach to trade reform. But many of these fears are exaggerated. For example, the fear that industrial country tariff and nontariff barriers preclude export success is at odds with the facts: tariff barriers are much lower now than when the newly industrializing countries of East Asia started their industrialization drive (box 3-2). Also, the fear that tariff escalation—rates that rise with the degree of processing—inhibits the processing of commodities is almost certainly exaggerated, given the influence of other constraints (as discussed later in this section). Distorted transport costs, a self-imposed impediment, are likely to be much more important.

Still, there are some serious external obstacles. Antidumping actions remain a favored device of protectionists, and one that is increasingly being adopted

by developing countries. World agriculture remains highly protected and subsidized, with little change likely in the foreseeable future. The Multifiber Arrangement continues to be a major distortion in global trade; its phaseout is heavily weighted toward the end of the transition process in 2005. We take up these topics in turn, beginning with the real obstacles.

Antidumping

Because they are rarely motivated by sensible economic criteria, antidumping actions remain a menace to free trade and can have serious repercussions, as exemplified by the recent EU action against central European steel. Disturbingly, developing countries are increasingly turning to antidumping actions.

The number of antidumping actions reported to the General Agreement on Tariffs and Trade (GATT) Secretariat has fluctuated widely over the past decade, but since 1990 there has been a steady rise in activity among antidumpers (figure 3-1). The number of

antidumping initiations reported in the year preceding June 1994 was 2.5 times greater than the number reported just five years earlier. These cases did not always result in an antidumping duty. Often the threat of a formal antidumping duty or the loss of customers resulting from uncertainty created by the secretariat's investigation induced an exporter to agree to a voluntary export restraint.[1]

No direct estimates of the impact of these antidumping cases have been made, but two telling comparisons are available. Messerlin (1990) has pointed out that EU antidumping cases during the 1980s covered a sizable amount of EU imports that was, for example, roughly equal to the value of EU imports of agricultural goods. Another comparison builds on the fact that the economics of antidumping and of OPEC price increases are the same. In both, the objective and the effect is to have importing users pay more for imports. In the United States the cost imposed on the U.S. economy by its own antidumping actions during the 1980s comes to about half the cost that the 1974 OPEC price increase imposed on the U.S. economy (Finger 1991).

Competition policy laws distinguish between discount pricing and predatory pricing. Predation refers to a situation in which a seller holds prices below cost sufficiently long to drive competitors out of business, then exploits the resulting monopoly situation to impose high prices. But there is little if any evidence to suggest that antidumping cases aim at predatory pricing. One legal scholar with considerable direct experience with antidumping cases has argued that predatory pricing was not even remotely present in any of the 767 affirmative antidumping determinations reached by Australia, Canada, the European Community, and the United States between 1980 and 1986 (Palmeter 1988). More conservatively, an OECD

study has found that by competition policy standards, exporters posed no threat to the competitiveness of the importing country or world industry in more than 90 percent of U.S. and EU antidumping duties imposed in the 1980s (de Jonquires 1995). Another piece of evidence that antidumping cases do not involve predatory pricing is the fact that the 1916 U.S. antidumping law has never been used successfully. This law offers the reward of triple damages for proven dumping cases, but it also imposes the burden

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Developing countries are increasingly turning to antidumping actions

Figure 3-1 Antidumping initiations reported to the GATT Secretariat, 1986–94

Number
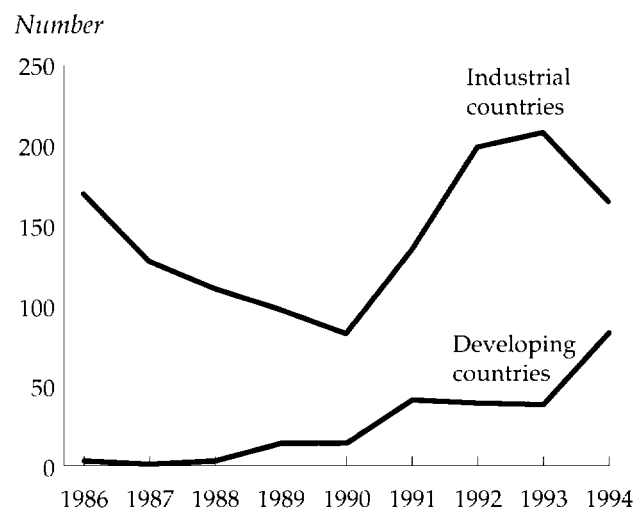
Source: GATT Secretariat.

of having to meet the legal standards of competition policy.

Predatory pricing is part of the rhetoric of antidumping, not part of the substance. In economics dumping is a precisely defined form of pricing. In politics it simply means trouble from imports. In law dumping follows its legal meaning, not its economic one. Antidumping is ordinary protection with a good public relations program. Accordingly, there is a need to strengthen the World Trade Organization's (WTO) rules on the application of such measures.

The developing world's involvement in antidumping actions is a recent development. During 1980–85 developing countries initiated only 34 of the 1,019 antidumping cases reported to GATT. In recent years, however, six developing countries accounted for more than 25 percent of the antidumping actions initiated in the five years prior to June 1994.[2] Mexico alone was responsible for nearly 25 percent of the developing country total, surpassing Canada in the number of cases reported. In addition, thirty-four of the forty-seven countries that have brought antidumping legislation to the WTO's Committee on Antidumping Practices since January 1995 are developing countries. While most of these antidumping systems have yet to be used, they represent significant potential for the spread of antidumping activity.

A subsidiary issue is the treatment of nonmarket economies—the socialist or formerly socialist ones. Contingent protection, such as antidumping initiations, is sometimes alleged to hit the exports of nonmarket economies harder than others. It is true that these economies, including China, account for a far higher share of antidumping cases than their share of U.S. or EU imports and that the law treats them differently. The main difference in the treatment is that the "fair value" of a nonmarket economy's exports is determined by valuing the inputs they use at the prices found in "similar" market economies. Despite the hurdles, however, a careful examination of the law and practice of contingent protection suggests that nonmarket economies are not discriminated against; the frequency of their cases is probably just due to their strong competitiveness in certain sectors.

How can the nonmarket economies avoid these problems? Joining the WTO helps a little, but the WTO allows the nonmarket economies to be treated differently. Proving that they are now market economies could also help, but market economy members of the WTO still face antidumping cases. Nonmarket economies must therefore try to fight their cases more effectively, for example, by using expert lawyers and providing documents that substantiate their market status.

Agriculture after the Uruguay Round

Progress toward trade liberalization in agriculture has been limited and uneven in recent years. While the Uruguay Round successfully brought agriculture under multilateral discipline, the extent of liberalization achieved fell short of expectations and is subject to the vagaries of implementation. A ceiling has been placed on export subsidies and aggregate domestic support. Tariffication has abolished nontariff barriers and replaced them with transparent, bound tariffs. Still, restrictions on market access remain substantial.

Even though the reductions in export subsidies are important, trade in many products will still be subjected to significant distortions at the end of the implementation period. With trade at current levels, subsidized exports can account for a third or more of trade in beef, veal, pork, wheat, and vegetable oils. More than a fifth of trade in poultry and coarse grains can still be subsidized.

The average tariff equivalents of post–Uruguay Round border measures in agriculture often are higher than the pre-Round applied rates. Many of the tariffs resulting from the tariffication process are prohibitive and, while they will be reduced during the implementation period, will remain high in many countries. Primary commodity exports of developing countries such as sugar, rice, and certain fruits will remain under high tariffs in many OECD countries. In many developing countries the high tariff bindings and the continuation of state trading enterprises with monopoly control of imports and exports will limit the benefits of the agreement.

Multifiber Arrangement

Multifiber Arrangement (MFA) quotas constitute a huge compulsory export tax on developing country exports of textiles and clothing. Their eventual removal will have highly beneficial welfare effects in industrial countries, with varying effects in developing countries. But because the phasing out will likely be delayed until the last moment—in 2005—the MFA, which covers virtually all fabrics and all significant developing country exporters, continues to represent a major distortion to world trade.

The export quotas imposed under the MFA are essentially set by importing countries but are administered by the governments of exporting countries. The allocation mechanisms used for quotas typically generate substantial costs by creating incentives for rent-seeking behavior or by stimulating production and exports that are unprofitable for the economy as a whole (Trela and Whalley 1995). For exporters the quota scheme is effectively the same as (though less transparent than) a set of export taxes that vary by product and destination.

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Table 3-2 Export tax equivalents of MFA quotas on apparel, 1992

(percent)

Supplier	United States and Canada	European Union
Latin America	20	18
South Asia	40	36
Hong Kong	18	16
Indonesia	47	48
Korea, Rep. of	23	19
Malaysia	37	32
Philippines	34	28
Taiwan, China	19	22
Thailand	35	36

Source: Chyc and others 1995.

Broad estimates suggest that the export tax equivalents are enormous, ranging from 16–48 percent and affecting exporting countries differently (table 3-2). The protection provided by the MFA quotas is all the more remarkable given that it is imposed on top of some of the highest tariffs on manufactured goods—about 13 percent on textiles and clothing imports from developing countries.

Product groups accounting for just over half of the total imports falling under MFA categories will be integrated with the GATT in three tranches during the first seven years of the agreement, with the rest to be eliminated at the end of the ten-year transition period. The importing countries are free to choose the products that will be integrated and, not surprisingly, have usually chosen to integrate products that are not subject to quotas or on which quota restrictions are not a binding constraint. As a result most of the liberalization provided for under the MFA will likely be deferred until the tenth year (2005), and even then will be subject to safeguard clauses.

The liberalization proposed under the Agreement on Textiles and Clothing will generate substantial welfare gains. The largest gains will likely accrue to the industrial countries that imposed the MFA's peculiar and perverse form of protection. Among exporters, the greatest gains will likely go to highly efficient producers whose current exports to industrial country markets are tightly constrained by quotas. Thus China, Indonesia, Thailand, and South Asia should gain from the abolition of the MFA. Also gaining will be countries that have demonstrated the capacity to develop clothing exports, only to be faced with a newly imposed quota, for instance Kenya. Exporters with large quotas

relative to their underlying competitiveness will lose from the abolition of the MFA, with Central America and the Caribbean (for example, the Dominican Republic) being vulnerable unless they can enhance productivity. Alternatively, they must begin to shift to other areas of comparative advantage, a course already taken by some East Asian countries (Hong Kong, the Republic of Korea, Singapore). The message of the MFA phaseout is that genuinely competitive production whose development has been inhibited by quotas will have an opportunity to flourish.

Tariff escalation

Tariffs and other trade barriers in major markets, and their tendency to increase or escalate with the level of a product's processing, are often cited as working against the efforts of commodity-dependent countries to increase domestic processing. Given the special relations and conditions of market access many developing countries have in OECD markets, the issues relating to tariff escalation are not as clear-cut as was once thought. Account needs to be taken of the Generalized System of Preferences (GSP) and the Lome IV Convention preferences some developing countries receive, including the least developed country category under the GSP.

To analyze the structure of EU tariffs, Safadi and Yeats (1994) developed a processing chain scheme and applied it to primary commodities exported from Sub-Saharan Africa. This analysis shows that the possibility of African countries receiving GSP, Lome IV, or least developed country preferences eliminates the effect of any nominal tariff escalation. For example, African preferential tariffs are zero at every stage in the four processing chains: hides and skins, leather, and leather manufactures; raw cotton, cotton yarns, and cotton fabrics; zinc ores, unwrought zinc, and zinc bars and sheets; and palm nuts and kernels and palm kernel oil. Thus, thanks to the influence of preferences, tariffs do not appear to have been a major constraint to the further processing and export of African commodities.

If the importance attached to tariff escalation has been exaggerated, then what explains the bias in the structure of many developing countries' exports away from processed products? For example, compared with imports from all suppliers, the structure of OECD imports of primary and processed commodities from low-income Sub-Saharan Africa is concentrated in unprocessed commodities (table 3-3).

First, some commodity processing operations, such as petroleum refining, ferrous metals, and tobacco manufacturing, involve highly capital-intensive and mechanized operations in which middle- and high-income countries hold a comparative advantage.

Table 3-3 Share of 1993 OECD imports of primary and processed commodities
(percent)

Commodity chain	Primary stage	Semiprocessed products	Final processed stage
Agricultural materials			
Low-income Sub-Saharan Africa	37	32	31
All countries	6	47	47
Ores and metals			
Low-income Sub-Saharan Africa	31	34	35
All countries	8	46	46
Tobacco			
Low-income Sub-Saharan Africa	100	a	0
All countries	42	a	58

a. No semiprocessed stages are defined for tobacco.
Source: Calculated using UN COMTRADE data based on Safadi and Yeats 1994.

Second, a number of comprehensive commodity-specific studies have shown that various barriers to market entry (aside from escalating trade barriers) work against further processing in some developing countries. In some cases international transport costs (discussed below) have been found to escalate with processing. And the final consumer market for some commodities like coffee, cocoa, and tea have high entry barriers that are associated with the market power of a few large oligopolistic firms (Scherer 1984). In summary, some of the externally imposed barriers to trade are significant for some developing countries. The remedy lies in OECD country efforts to further open their domestic markets.

Transport costs

The influence of transport costs on developing country trade has been a neglected subject, in part because of the lack of easily accessible data on their incidence and in part because of presumptions that freight costs are less important than tariffs and are beyond the control of exporters. Recent analysis suggests that both presumptions are erroneous, and that in some instances transport costs can outweigh the impact of tariffs.

The freight costs for African exports to the United States are usually considerably higher than on similar goods originating in other countries. These charges conceal very high rates of effective protection for processed goods—which may be thought of as the cost margin below domestic producers that exporters must achieve on value-added production in order to be able to compete—a point that significantly reduces incentives for new investment in export-oriented production activities. In the past many African countries adopted anticompetitive cargo reservation policies to

foster the development of national fleets. In fiscal 1991 Sub-Saharan Africa's net freight and insurance payments were $3.9 billion, or 15.0 percent of total exports, compared with 5.8 percent for all developing countries. Net transport and insurance payments average more than 25 percent of total exports for one-third of Sub-Saharan Africa countries. And the trend of costs is rising.

Summary statistics on 1993 transport costs show that Africa is at an important cost disadvantage relative to its competitors. Figure 3-2 shows median costs, represented by a horizontal bar, and the range of costs around the median, represented by a vertical bar whose endpoints mark the first and third quartiles of export volume. The shaded bars show the margin of African costs over those of other countries. For example, the median vessel nominal freight rate for middle-income West Africa—10 percent—is about 2 percentage points higher than that paid by other developing countries. This compares with the average 2.4 percentage point reduction in industrial country tariffs (to 3.9 percent) achieved in the Uruguay Round. Some African exports encounter even higher transport costs. For example, 25 percent (the third quartile) of Sub-Saharan Africa's air exports encounter freight rates exceeding 26 percent, and about a quarter of low-income West Africa's vessel shipments have nominal freight rates of more than 19 percent.

The disincentive effects of these high transport costs are captured by the effective rates of protection. For animal and vegetable oils the transport effective rate of protection of 56 percent is more than five times higher than the corresponding nominal rate of protection.[3] Thus while Africa is an important producer of several types of oilseeds, like groundnuts and copra, further processing for export is inhibited by transport costs.

Figure 3-2 African transport costs as a share of export value

Percent

Quartile of exports

	Third
	Median
	First

Margin of African costs over other developing countries
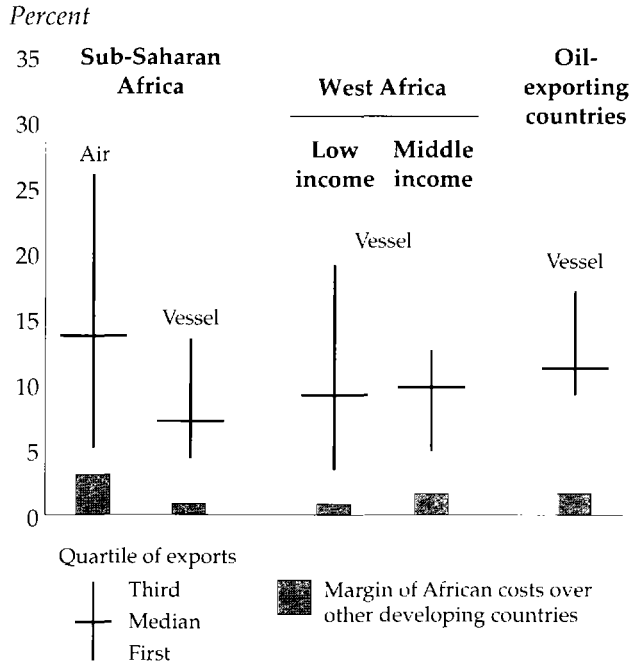
Source: Nominal transport costs calculated from U.S. Department of Census trade tapes. Pre-Uruguay Round tariff averages are from Erzan and Svedburg (1989).

What type of corrective policy measures could be used to address these distortions? Any approach should recognize that two types of factors affect transport costs—those that are not subject to policy control and those where considerable scope for corrective action exists. Distance is one factor that is not subject to policy control—freight rates vary directly with distance, and countries that are geographically removed from their major markets obviously cannot change their location. Similarly, countries that export a high share of bulky low-value products face higher nominal freight costs than countries that ship high-value products with low stowage factors. However, governments and traders generally have far more policy options for reducing transport costs than is generally recognized. These options include such measures as cargo bulking to achieve economies of scale in transport, rationalization of shipping services and improved scheduling for liners, adoption of procedures to speed vessel turnaround, utilization of lower-cost tramp services where feasible, development or improvement of coastal feeder services, adoption of new transport technologies, promotion of shippers associations, and port and storage improvements.

Many developing countries' governments have adopted anticompetitive cargo reservation schemes in the hopes of achieving objectives such as the development of national fleets. These schemes have been largely unsuccessful in promoting national lines, but their anticompetitive effects have resulted in markedly higher freight rates. World Bank studies have shown that deregulation and the adoption of measures to promote competition for international transport services can significantly lower freight costs for developing countries (Bennathan and others 1989).

Regional agreements as a vehicle for integration

Regional integration agreements—regionalism for short—are a hot item on the international trade agenda. Regionalism covers an enormous diversity of arrangements, from fully fledged common markets to customs unions (characterized by common external tariffs) to ordinary free trade areas. This diversity is one reason it is hard to make a conclusive assessment of such arrangements. Another is that many agreements—the North American Free Trade Agreement (NAFTA), the EU association agreements, the nascent Asia-Pacific Economic Cooperation arrangement—are of recent vintage.

Contrary to popular belief, the regional concentration of trade has not grown much in the second half of the twentieth century except within the European Union, which is the principal example of deep integration (involving harmonization of standards, policies, and institutions). In fact, the fastest-growing trade area has been East Asia, where regionalism is largely absent except for the Free Trade Agreement of the Association of Southeast Asian Nations. This experience suggests that joining a trading bloc is not necessary for successful trade performance, but can in some instances (particularly in arrangements between developing and industrial countries) generate better and more secure market access, increase policy credibility, attract investment, and improve access to technology. The benefits are far from automatic, however.

Arrangements between developing and industrial countries

The expansion of NAFTA to include Mexico (in addition to Canada and the United States) and the network of special agreements tying various developing countries to the European Union illustrate the wide array of new forms of integration between developing and industrial countries. There are different types of preferential arrangements: unilateral preferences (the European Union's Lomè Convention), free trade areas (NAFTA with a possible extension to Chile), customs unions (the European Union and Turkey), association or preferential agreements (the agreements between

the European Union and Central and Eastern European countries and the Baltic states, and between the European Union and certain Mediterranean countries), and enlargement of a regional integration agreement through accession (Greece, Portugal, and Spain joining the European Union).

While integration between developing and industrial countries started in the 1980s, it has assumed far greater significance in the 1990s. Between 1991 and 1995 the European Union signed association agreements with nine European transition economies, concluded similar agreements with Israel, Morocco, and Tunisia, and is currently negotiating with several other Middle Eastern and North African countries. The main parts of these agreements deal with establishing free trade areas for industrial products over a period of ten to twelve years along with, at least in Europe, some liberalization in services. The European Union recently created a deeper but narrower arrangement with Turkey establishing a customs union in industrial goods and perhaps eventually in agriculture. The creation of NAFTA in 1993 is thought by some as laying the groundwork for a major North-South free trade area in the Western hemisphere. Discussions are under way to establish a free trade area of the Americas and another in the Asia-Pacific region. It is too early to know whether these efforts will succeed, but they illustrate the enthusiasm for such arrangements.

Thanks to their exclusiveness in most cases—it is too early to know, for instance, whether liberalization under the Asia-Pacific Economic Cooperation agreement will be done on a most favored nation basis—and despite the inherent dangers involved in regionalism, preferential arrangements have become an alluring model. Many developing countries view preferential arrangements as a means of securing access to technology, capital, and markets, and sometimes of fostering increased (or at least nondecreasing) financial transfers. In addition, the arrangements are seen as a mechanism for achieving greater international credibility of policy reforms. In short, some developing countries see integration as both a potential engine of economic growth and as a way to develop domestic institutional settings conducive to sound economic policies.

But is regionalism actually advantageous to developing countries? The first part of the answer is that they are not necessary for success. East Asia's spectacular economic success has evolved largely independently of special arrangements with industrial countries or institutions of regional integration. Chile and Mauritius provide further examples. Their dramatic economic growth can be attributed to sound domestic policies—observing market-oriented fundamentals, vigorous accumulation of physical and human capital, and the willingness to exploit the opportunities offered by international markets.

The second part of the answer is that regional integration is not sufficient for economic success. For instance, Central and Eastern European countries inherited huge distortions in their trade patterns that were a major factor behind the frequently big changes in their exports to the European Union during the first stages of their transitions. Indeed, the fact that not every country with an EU association agreement experienced an export boom (Kaminski, Wang, and Winters 1995) and that many of the export gains occurred in products not subject to extensive liberalization measures (Kawecka-Wyrzykowska 1995) suggests that the EU agreements were not sufficient for export success.

One frequently cited—but overstated—benefit of these agreements to developing countries is access to industrial markets. The European Union and the United States have, with a few notable exceptions, relatively liberal import regimes for their developing country trade partners (through low most favored nation tariffs and widespread application of Generalized System of Preferences rates). Thus the benefits of improved market access are rather limited for most developing country partners unless they gain access to industrial countries' protected "sensitive" markets, such as agriculture, textiles and clothing, and steel. However, these are the very sectors that are most often excluded from or subject to constraint under regional integration agreements between developing and industrial countries.

The benefits of integration (global or regional) are not static. The depth of a regional agreement—as measured by the scope of precommitments to cooperation, harmonization, and liberalization—also influences the dynamic gains to integration. Major gains stem not only from changes in the level of imports but also from higher investment, increased competition, better use of economic resources, the economies of scale that develop from access to larger markets, and the higher potential for export-led growth. Gains also arise to the extent that a developing country's national institutions become like those of its industrial country partners. In this regard the enlargement of the European Union to include relatively poor southern European countries represents the deepest integration between developing and industrial countries (Winters 1993). Other agreements are less inclusive but nevertheless address issues of nonborder policies such as competition policies, subsidies, technical standards, environmental regulations, and intellectual property rights.

A very important benefit of the institutional reform associated with integration between developing and industrial countries is the enhancement of the developing country's credibility in its commitment to economic reform and its attractiveness as a location for investment. Once the process of accession to the

European Union had begun, Spain and Portugal experienced large inflows of foreign direct investment. Anticipating NAFTA, foreigners poured about $30 billion of foreign direct investment (FDI) into Mexico during 1990–93. While some portion of this flow can be attributed to the liberalizing measures that had been introduced earlier, at least some of it is likely to have been directly attributable to NAFTA.

In a similar vein, the combination of domestic liberalization and market access has lured foreign investors to Eastern Europe. In 1994 the three most advanced reformers—the Czech Republic, Hungary, and Poland—received FDI inflows of $19 billion. There is already evidence that multinational corporations investing in these countries have contributed to industrial restructuring, the diffusion of managerial and marketing skills, and the growth of the export sector. Polish Fiat became Poland's largest exporter to the European Union in 1993, and multinational corporations have contributed immensely to the expansion of Hungary's intraindustry trade with the European Union.

Regional arrangements are neither necessary nor sufficient to stimulate FDI inflows, however. Chile, for example, has attracted substantial volumes of FDI, thanks to private sector reform and a liberal investment regime. By contrast, Bulgaria and Romania, although partners to EU association agreements, have failed to attract foreign investors—mainly because of the less-advanced state of their market-oriented reforms.

Regionalism can enhance growth by improving efficiency and stimulating investment. But the degree of success depends on a country's commitment to macroeconomic discipline. The experiences of Greece, Portugal, and Spain offer important insights. Greece has experienced slow growth, low investment, and persistently high inflation since its accession to the European Union, while Portugal and Spain experienced an impressive turnaround in growth and falling inflation. The difference is that generous transfers from the European Union (amounting to about 5 percent of GDP) have weakened pressures to necessary adjustment in Greece, while neither Portugal nor Spain has allowed these transfers to affect their commitment to rigid fiscal policy (box 3-3).

The growing trend toward regionalization changes the economic possibilities for the countries that are excluded from regional blocs, who face losses from FDI diversion and more difficult market access to regional blocs than bloc members. For instance, the preferences given to EU producers and the investments by multinational corporations in the automobile industries of European associates have been largely diversionary. Japanese and Korean producers and Eastern European consumers lose from such developments.

Arrangements between developing countries

Trade arrangements between developing countries are a different proposition from developing-industrial ones. Because of their small size and limited scope for economies of scale, such arrangements may do little to enhance participants' policy credibility in the way that, for example, commitment to an EU arrangement would. And although the empirical evidence on the most recent arrangements is still too preliminary to support firm judgments, past experience suggests that unless such arrangements are pursued in the context of liberal policies relative to the rest of the world, they will be harmful.

Earlier regional integration agreements between developing countries were carried out in the context of inward-looking, import-substituting industrialization strategies and a large public sector. With high protection, these agreements generated more trade diversion than trade creation. For instance, trade among members of the Central American Common Market went from 2 percent of their total trade before the formation of the common market to about 20 percent after, with most of the increase in light manufactures that had previously been imported from industrial countries. Labor can also be diverted. For instance, protection of labor-intensive rice production in Côte d'Ivoire led to an inflow of labor from neighboring countries and to misallocation of resources.

The more recent, outward-looking agreements are among countries with more liberal trade regimes that have privatized and deregulated large parts of their economies. Thus they are less likely to fail. In Latin America the main agreement is Mercosur. Bilateral free trade agreements have also mushroomed, including Mexico-Venezuela, Chile-Mexico, Chile-Colombia, Chile-Venezuela, and more. Chile is also negotiating a preferential trade agreement with Mercosur. In Asia the Association of Southeast Asian Nations (ASEAN) has initiated a process of integration, as have South Asian countries. The ASEAN Free Trade Agreement has been in place for three years—almost as long as NAFTA—and during that time intra-ASEAN trade has risen substantially, trailing only the group's trade with Japan and the United States in value. In Sub-Saharan Africa new integration efforts include the Cross-Border Initiative.

The possibility of trade diversion rather than trade creation suggests that regional agreements between developing countries need to integrate further with the world market by continuing to lower external tariffs (common or not) and by integrating with the major economic entities (NAFTA, the European Union, Japan, and Asia). For instance, Chile is negotiating an agreement with Mercosur as well as with NAFTA, and it has started talks with the European Union. It is important that such efforts do not exclude Japan and the rest of Asia, or they

Box 3.3 Liberalization is not enough: Greece, Portugal, and Spain following EU accession

Joining the European Union (then the European Community) led to very different outcomes for Greece than for Portugal, and Spain. Output growth accelerated in Spain and Portugal but fell in Greece, where unemployment soared. These different outcomes were largely the result of different domestic policies.

Before joining the Union—Greece in 1981 and Portugal and Spain in 1986—the three countries embarked on similar trade liberalization policies. They also received significant EU structural transfers intended to offset the adjustment costs associated with accession. By 1993 net official transfers—comprised mainly of EU transfers—had reach 5.6 percent of GDP in Greece and 3.3 percent in Portugal. Net transfers also rose in Spain, though they only amounted to 0.6 percent of GDP.

Despite higher aid flows, Greece's government budget deficit rose from an average 4.5 percent of GDP in the five years before joining the Union to 10.1 percent in 1983–87. By contrast, Portugal and Spain consolidated their deficits as they introduced new value-added taxes. Portugal also embarked on a major privatization program. Monetary policy was looser in Greece than in the other two countries, in part because of its fiscal deficits. Money growth in Spain and Portugal fell after EU entry, while in Greece it continued at nearly 25 percent a year, as it had in the five years before entry. As a result Portugal and Spain were eventually able to join the European exchange rate mechanism; Greece was not.

Improved macroeconomic stability in Portugal and Spain bolstered the confidence of foreign investors, who were also attracted by low labor costs. Both countries attracted large amounts of private capital after their entry into the Union—foreign direct and portfolio investment after accession rose by some 3 percent of each country's GDP. Greece's credit ratings also rose in the period before EU entry, but they were later downgraded, there was no inflow of portfolio capital after accession, and foreign direct investment actually fell a little.

Source: Alogoskoufis 1995.

Within a few years of joining the Union inflation rates fell by half in Portugal and Spain, partly as a result of the price discipline imposed by real exchange rate appreciation following accession. This effect was strengthened when Portugal and Spain joined the exchange rate mechanism. Greece, on the other hand, experienced a jump in inflation to nearly 20 percent after joining, and did not get the inflation benefit of currency appreciation or exchange rate mechanism membership. However, imports of cheaper manufactures from the Union after liberalization did help dampen inflationary pressures in the tradable sectors of all three countries.

EU membership brought considerable benefits for Portugal and Spain

Inflation and budget deficits (five-year averages)

Percent
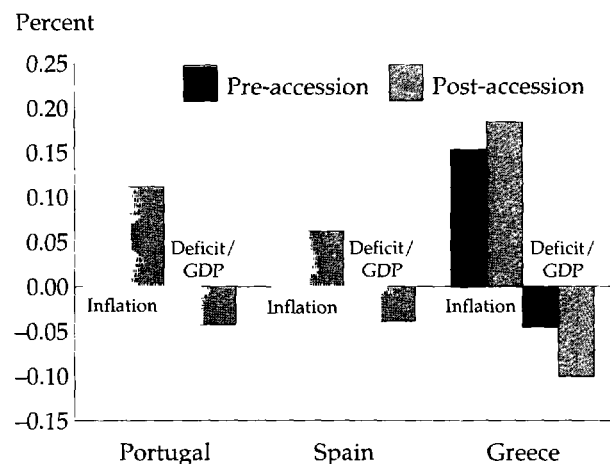
will run the risk of generating significant amounts of trade diversion (Leipziger and Winters forthcoming).

Conclusion

We can draw several conclusions about the costs of trade reform and the obstacles:

- The costs of trade liberalization and the associated problems of political economy must be managed by reforming governments, but the costs must be weighed against the opportunity costs (not least, low credibility) of a gradualist approach.
- While some of the obstacles to trade integration are external, others are domestic—and under the control of reforming governments.

- Regional trade arrangements are neither necessary nor sufficient to successful trade reform, though they may help cement it.

Countries that lag others in integrating with the global economy are confronted with the choice of how much to liberalize, how fast, and which path to follow: multilateralism, regionalism, unilateralism, or some combination. While the benefits and costs of liberalization are not fully understood, the benefits tend to be higher than theory would suggest (granted appropriate complementary policies) and the costs more moderate.

The barriers to developing country exports have never been lower—putting aside self-imposed barriers—and the later a country turns to trade reform, the fiercer the competition will be. Regionalism may help

countries fight the battle through enhanced access and policy credibility, but there is no substitute for a genuinely nondiscriminatory and liberal import regime, which benefits producers and consumers alike.

Notes

1. During the 1980s almost half of U.S. antidumping cases were superseded by voluntary export restraints (Finger 1993).

2. Brazil, Colombia, India, the Republic of Korea, Mexico, and Turkey notified GATT of 215 of the 815 antidumping initiations and 164 of the 521 provisional duties reported between July 1989 and June 1994 (GATT Secretariat).

3. Since the effective rate of protection measures the difference between value added in the presence of protection (and without trade barriers), relatively low nominal freight costs can produce quite high effective rates of protection for low value-added products.

Integration and successful commodity producers

Most of the countries that have been the slowest to integrate with the global economy are primary commodity–dependent countries—primary commodities account for more than half of their exports. Although many commodity exporters—notably in Sub-Saharan Africa, the Middle East and North Africa, and Central America—suffer from low productivity in the primary sector and an inability to diversify their production and export structures, others are among the fast growing. During the early 1980s sixty-nine of eighty-four developing countries were commodity-dependent (in the sample for which comparable data were available). Of these, fifteen were among the fast-growing fast integrators identified in chapter 2 and sixteen were among the slow-growing slow integrators. Furthermore, the commodity-dependent fast-growing countries, which included Chile, Indonesia, Malaysia, Mauritius, Mexico, Morocco, the Philippines, Turkey, and Thailand, have actually grown faster in per capita terms than the fifteen developing countries that are primarily manufactures exporters.

What characteristics distinguished the performance of the commodity-exporting strong integrators, and what underlying policies accounted for these characteristics? The successful exporters had highly productive commodity sectors, possessed the capacity to diversify to nontraditional (typically, high value-added) commodity exports, and maintained macroeconomic stability. Improved productivity and diversification were the consequence of policies conducive to high investment, of which macroeconomic stability was the essential ingredient. And successful exporters typically were able to implement their policies with the support of strong institutional and human capacity and sound and sustainable public investment programs.

Investment was also encouraged by policies that:
- Strengthened the private sector
- Attracted foreign direct investment
- Developed research and infrastructure
- Promoted financial soundness and flexibility.

This chapter draws on practical examples from successful commodity exporters that illustrate their policies. These examples suggest that the persistent dependence on a few traditional commodities that often accompanies slow growth and failure to integrate with the global economy is a symptom of policy and institutional weaknesses. Thus there is no inevitable causal link running from commodity dependence to the failure to improve productivity and to diversify.

Defining success

What distinguishes successful from unsuccessful commodity producers are high levels of productivity in commodity production, as evidenced by investment and growth in the commodity sector; an ability to diversify into nontraditional commodities, as evidenced by a high share of new export markets; and macroeconomic stability. Underlying all three characteristics is the ability to attract domestic and foreign investment. This section examines these characteristics, while the subsequent section examines some of the practices adopted by successful commodity producers.

High productivity in existing commodities

Successful and unsuccessful commodity-dependent exporters exhibited a pronounced difference in per capita growth in capital stock and income during 1980–90 (figure 4-1). Countries that invested more tended to grow much faster—nearly 3 percentage points a year—and have been fast integrators. The GDP of moderate, weak, and slow integrators, on the other hand, fell during this period. Though strong performers diversified faster into manufacturing, this was not at the expense of slower growth in the primary sector. In fact, the disparity in investment performance is especially striking in agricultural investment, where the capital stock actually fell for weaker performers.

Figure 4-1 Annual per capita growth in output, capital, and investment for commodity-dependent exporters, 1980–90

Percent
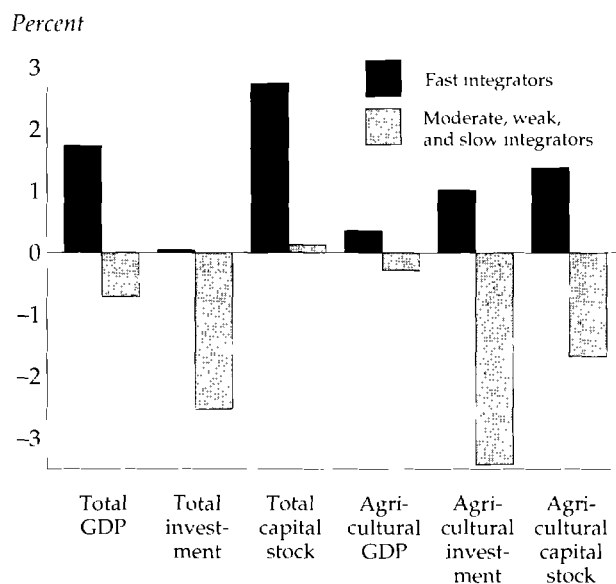
Source: World Bank data and staff estimates.

Most commodity-exporting slow integrators have retained the traditional production, marketing, and export systems established during the colonial period. Production is undertaken by small producers with limited resources and education, while pricing, marketing, and export systems are government-controlled and often noncompetitive. Such systems provide limited opportunities for producers and traders to exert initiative, introduce innovations, or learn new approaches. Many of these less productive commodity exporters are subsistence economies that are unable to generate significant domestic savings, and their unstable macroeconomic environment deters foreign investors. For example, Latin America and Asia have managed to attract large inflows of private capital into mining projects; Sub-Saharan Africa has not. A recent study shows that countries with major mining sectors usually invest 5–10 percent of production value in exploration. Many Sub-Saharan African countries, on the other hand, attracted investment of only about 1 percent of production value (table 4-1). A number of Sub-Saharan African countries are endowed with high-quality mineral resources and low labor costs and face low or insignificant tariff barriers to exports of primary products. Thus the figures in table 4-1 underscore the importance for sustainable growth in mineral production of a sound macroeconomic frame-

work, effective institutions, and adequate transport infrastructure.

Diversification into nontraditional commodities

Commodity-dependent countries have varied widely in their capacity to increase diversification and productivity, as evidenced by the composition of their export growth in real terms over 1972–92 (figure 4-2). The four successful producers chosen—Chile, Indonesia, Malaysia, and Thailand—experienced spectacular growth in nontraditional exports such as fruits and vegetables and shrimp, and steady growth in other agricultural categories. By contrast, slow integrators (excluding oil exporters) made little headway in nontraditional exports (shrimp is a partial exception) and actually regressed in traditional products such as sugar and fats and oilseeds.

Opportunities for dynamic growth in nontraditional commodities are particularly strong in horticultural products. Between 1985 and 1994 world imports of fresh and simply preserved vegetables increased from $8.2 billion to $18.8 billion; fresh and dried fruits and nuts grew from $12.3 billion to $24.2 billion. In 1994 the total value of these imports was about twice as much as the export value of coffee from developing countries (the most important agricultural commodity of developing countries in terms of export value). Major exporters of vegetables include the United States ($1.78 billion in 1994), China ($1.42 billion), Mexico ($1.26 billion), and Thailand ($738 million).

The horticultural market is competitive because, unlike tropical products, developing country horticultural exporters must compete with industrial country exporters. Horticultural trade also requires sophisticated marketing skills. Delivering perishable goods requires not only well-organized transport, communications, and other infrastructure but also

Investment in mineral exploration varies widely

Table 4-1 Average annual world mineral exploration expenditure, 1980–89
(millions of 1989 U.S. dollars)

Australia	560
Canada	600
United States	360
South Africa	180
Sub-Saharan Africa	100
Other	700
Total	2,500

Note: Excludes Soviet Union and Eastern Europe.
Source: World Bank data and staff estimates.

Figure 4-2 Real annual growth in commodity exports, 1972–92

Percent
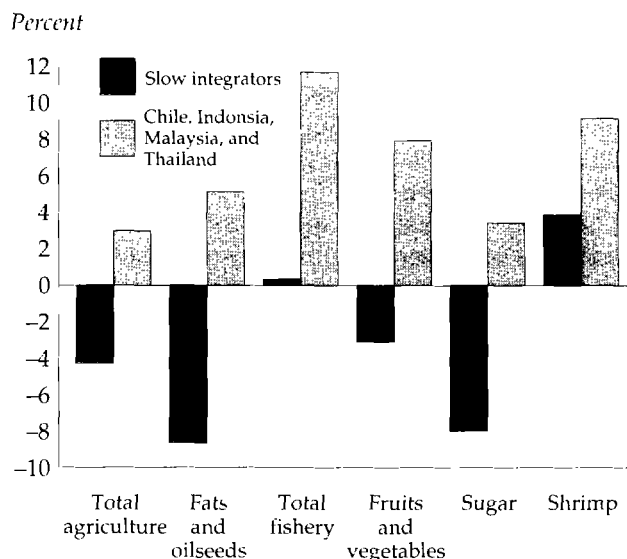
Source: World Bank data and staff estimates.

efficient organization and management of these systems. Information and skills allowing penetration of markets protected by complicated tariff and non-tariff barriers are also required. As discussed below, foreign direct investment is one way to acquire this information and these skills.

Cut flowers are another booming commodity. World cut flower exports went from $1.25 billion in 1985 to almost $4 billion in 1993. In that year the world's largest exporter was the Netherlands, with exports of $2.2 billion, followed by Colombia with $382.5 million. Other major developing country flower exporters are Mexico, Costa Rica, Thailand, Kenya, and Ecuador. Colombia has been the most successful cut flower exporter among developing countries because of the cost advantages that come from its abundant land, favorable climate, and low-wage labor force. These factors, as well as the development of air transportation and major changes in government policies in the late 1960s (such as reduction of import restrictions and devaluation of the domestic currency), enabled Colombia to compete with local producers in the U.S. market, where demand was increasing rapidly.

Macroeconomic stability

The influence of macroeconomic policy deficiencies is evidenced by the correlation between the size and volatility of budget deficits and the degree of integration (table 4-2). Among commodity exporters at the start of the period (defined as those with at least half their exports in primary commodities) the fast integrators ran much lower deficits—a median of 4.3 percent of GDP compared with 7.1 percent for the slow integrators. And the commodity-dependent countries that invested more and grew faster were also the fastest integrators. Indeed, the growth of the fast integrators even outpaced that of non–commodity dependent countries. Fast integrators also suffered smaller

Fast-integrating commodity-dependent exporters achieved better outcomes

Table 4-2 Integration, policy, and performance in commodity-dependent developing countries, 1984–93
(percent)

Indicator	Non–commodity dependent countries	Commodity-dependent countries	
		Fast integrators	Slow integrators
Number of countries	15	15	16
Budget deficit as a share of GDP	–4.98	–4.29	–7.09
Budget deficit volatility	2.60	2.65	5.82
Inflation[a]	14.00	13.94	7.25
Inflation volatility[a]	0.53	0.57	1.82
Real per capita GDP growth	1.24	2.09	–1.80
Per capita investment growth	–0.45	3.35	–7.20

Note: Commodity reliance is defined as countries with at least half their exports in primary commodities. See chapter 2 for definitions of fast and slow integrators.
a. Measured by the consumer price index.
Source: World Bank data and staff estimates.

terms of trade losses than slow integrators, thanks in part to much faster growth in the share of manufactures in exports over the period analyzed.

Perhaps surprisingly, there was no major difference between fast and slow integrators within the commodity-dependent group with respect to real exchange rate volatility, and the slow integrators actually experienced lower (median) inflation and black market premiums. Part of the explanation lies in the CFA franc zone countries, which feature prominently among the slow integrators. Throughout the period the CFA franc was stable in value against the French franc, even though it became progressively overvalued in real terms, and the CFA countries exhibited slow growth and growing dependency on foreign aid.

In addition to low investment, other causes of dependency include mishandling of commodity price booms, inefficient public sector processing, and, for a few large producers, an inability to expand production without inducing falls in prices (for instance, in bananas, cocoa, coffee, cotton, tea, and tobacco).[1]

Fostering productivity

Successful commodity producers, as discussed above, have established climates that are conducive to foreign and domestic investment. This section outlines some of the practices implemented by successful commodity producers using a series of case studies. These practices include:

- Strengthening the private sector and achieving large gains in efficiency by abolishing public sector monopolies in production and marketing.
- Attracting foreign capital and technology by fostering market incentives in the private sector and by removing regulatory barriers, especially to foreign firms.
- Enhancing research and development and infrastructure capacities to maintain competitiveness.
- Promoting financial flexibility to strengthen export and inventory financing of commodities.

Strengthening the private sector

Private and public sectors have important complementary roles to play in commodity-dependent countries. The private sector provides the engine of investment and productivity growth, while the public sector provides a liberalized regulatory framework, physical infrastructure, an educated workforce, and perhaps sponsorship of research and technology developments. Too often the public sector in commodity-dependent countries has cosseted production and protected it from effective competition. Large primary commodity sectors have sometimes been viewed as the "family silver"—a strategic sector of national

importance needing to be preserved by a public sector monopoly. But that strategy has frequently proved counterproductive. Cross-country experience shows that removing of a host of public sector interventions—for example, in marketing, production, and price control—can produce large efficiency gains.

Examples of successful liberalization in commodity sectors come not only from the dynamic economies of East Asia (which were heavily commodity reliant a few decades ago) but also from fast-growing countries from Chile to Uganda. A number of other countries in Africa, South Asia, and Latin America have also started to liberalize.

Market liberalization is often accompanied by elimination or privatization of monopolistic state-owned enterprises. For example, one study of cocoa marketing costs shows that in 1989 costs (excluding explicit taxes) were two to three times higher in countries where marketing is controlled by state-owned enterprises, such as Côte d'Ivoire and Ghana, than in countries with liberalized markets, such as Indonesia and Malaysia. At that time marketing costs in the first group accounted for as much as half the selling price (figure 4-3). The privatization of marketing boards in several African countries has been an important element in the market liberalization that revived many commodity subsectors.

In the case of Côte d'Ivoire a further element has been the attainment of macroeconomic stability with the devaluation of the CFA franc. Before devaluation Côte d'Ivoire was able to maintain a high market share

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State involvement makes for high marketing costs

Figure 4-3 Cocoa marketing costs as a share of the selling price, 1989

Percent
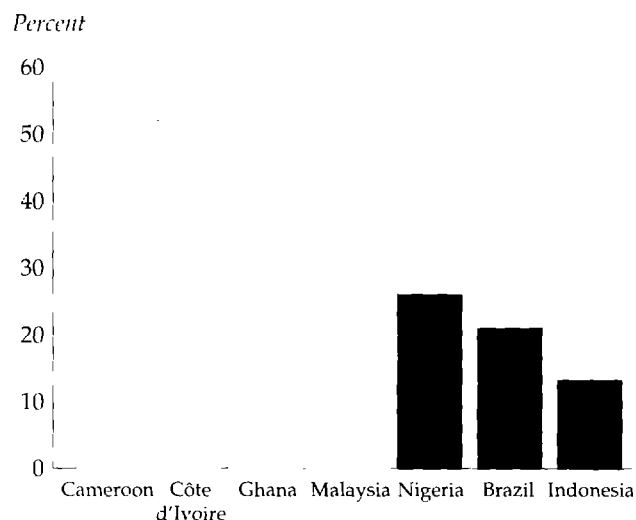
Source: World Bank staff estimates based on Ruf 1993.

Table 4-3 Tea productivity and profitability in selected producing countries, 1991

	Sri Lanka		India, private		
Indicator	*Public*	*Private*	*North*	*South*	*Kenya, private*
Yield (kilograms per hectare)	1,268	2,442	2,127	2,300	2,237
Intake per tea plucker (kilograms per day)	13.52	24.59	26.22	25.24	48.0
Labor per hectare	3.2	2.7	2.7	2.5	2.2
Cost of production (dollars per kilogram)	1.87	1.54	1.52	1.39	0.94
Revenue (dollars per hectare)	2,574	4,957	4,318	4,669	4,338
Gross profit (dollars per hectare)	203	1,196	1,085	1,472	2,438

Source: World Bank data and staff estimates.

despite overvaluation, largely because it adopted market-based reforms in the cocoa sector. With devaluation, the benefits of these past reforms have had a chance to come through.

In Tanzania the market liberalization process that began a few years ago abolished the state-controlled marketing boards and significantly changed the system of export marketing and pricing for cashews, coffee, and cotton. As a result a large number of private traders, many of them foreign or foreign-affiliated, became active in purchasing and exporting, particularly in cashews. Farmgate prices for cashews increased sharply—more than doubling in real terms between 1988/89 and 1991/92. Cashew production which had stood at 20,000 tons in the late 1980s, increased to 47,600 tons by 1993/94, and export volume increased sixfold between 1990 and 1993. Farmgate prices also increased sharply for coffee, by about 40 percent (in real terms) between 1988/89 and 1992/93, at a time when world prices were declining.

The low productivity of state-owned tea estates in Sri Lanka illustrates the desirability of effective privatization (table 4-3). In 1991 per hectare yields and gross profit per hectare on the state-owned estates were significantly lower than those of private estates and considerably lower than in other countries. In 1992 the Sri Lankan government consolidated 422 loss-making, state-owned tea, rubber, and coconut estates into 22 joint stock companies and contracted management out to private firms in an attempt to make them more efficient. Thus far the plan's objectives have been frustrated and the state-owned estates continue to record large deficits. The main reason for this failure seems to have been the absence of an institutional framework for transferring effective control to the private companies. The managing companies were not allowed to acquire ownership in the ventures, and because the estates continued to be state-owned, wage costs increased substantially. Moreover, the financial incentives for investment were not sufficiently attractive.

The experiences of Ghana and Peru show that declining performance in the gold mining sector can be turned around through privatization, legal stability, and a business climate that welcomes both domestic and foreign investors. In the early 1960s Ghana's annual gold production was about 31 tons; by 1983 production had dropped to 8.6 tons because of insufficient investment in exploration and extraction technologies (figure 4-4). Low investment was mainly the result of a poor business environment. In 1983 the government embarked on a privatization program that included measures aimed at encouraging foreign direct investment, especially in the mining sector. Three state-owned mines were divested and a public offering of government stock of the largest gold producer, Ashanti, was held. In

Ghana's gold production jumped once mines were privatized

Figure 4-4 Gold production in Ghana, 1974–94

Metric tons
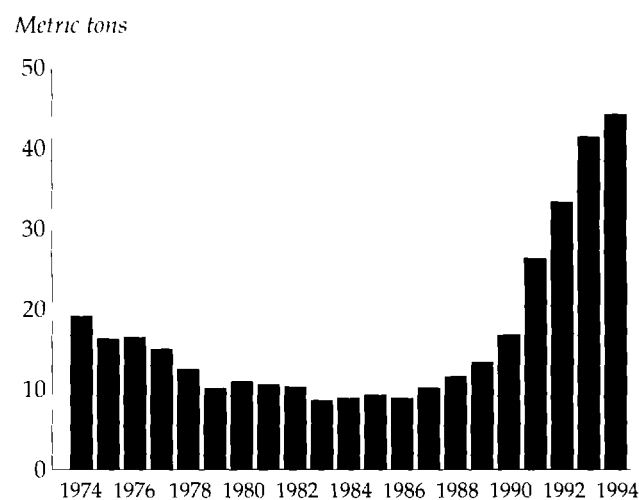
Source: World Bureau of Metal Statistics, *World Metal Statistics Yearbook.*

addition, a stronger legal and regulatory framework was established and government mining institutions were reformed. As a result of these reforms gold production (excluding that of small miners) soared from 8.8 tons in 1984 to nearly 45 tons in 1994. The introduction of the Small-Scale Gold Mining Law of 1989 resulted in an increase in government purchases of gold from small-scale miners from 0.3 ton in 1989 to 1.0 ton in 1993, or from $3.7 million to $12.6 million in dollar terms.

In Peru, as in Ghana, the mining sector was stagnant for a long time. In 1991 the government initiated a radical stabilization and structural reform program. The Free Market Marketing Decree promotes privatization and provides a favorable legal and financial environment for foreign investors, including allowing foreign acquisition of domestic mining concerns. In 1994 foreign acquisitions of mining enterprises in Peru totaled $714 million and investment commitments totaled $2.2 billion.

Applying foreign technology

Commodity-dependent fast integrators have generally succeeded in attracting foreign capital and technology to develop new export commodities. The lesson to be drawn from the following cases is that foreign technology is best utilized when prices have been liberalized and excessive regulatory barriers removed.

The chicken industry in Thailand provides a good example of technology and knowledge transfer from foreign investor to recipient. During the early 1970s several Thai feed milling enterprises merged and expanded into poultry production. They developed contractual ties with existing producers; built slaughterhouses and modern processing facilities to produce value-added chicken cuts that met Japanese consumers' taste; imported technology from Japanese investors in the areas of genetics, nutrition, and disease control; and obtained technical assistance and capital from those investors. The government offered investment incentives and research and quality control services. Thailand also adopted the streamlined, vertically integrated production, processing, and overseas distribution systems developed by Japanese companies. As a result the Thai chicken industry became one of the largest, most cost-efficient, and technically advanced meat industries in the world, with exports of $351 million in 1993.

The transfer of Japanese technology and knowhow to East Asian developing countries is of particular interest. Japanese foreign direct investment often takes a distinctive form, especially if undertaken in Asia, where it is called *kaihatsu-yunyuu*. Its main characteristic is that Japanese investors, in many cases major trading companies, bring most of the input materials as well as production, processing, and mar-

keting systems to host countries to produce and export products that match the particular tastes of Japanese consumers. In most cases these products are exported exclusively to the Japanese market through marketing channels that are often arranged up to the retail level by Japanese investors. Shrimp in China, Indonesia, and Thailand, vegetables in China and Vietnam, and processed (tinned) fruits in Indonesia, Malaysia, and Thailand are the most sizable examples of this type of investment.

The risks of shutting out foreign technologies are shown by the use of seed lists, which often constitute a counterproductive barrier to the import of agricultural technology. Governments in many countries, particularly developing countries, maintain lists of plant varieties for which commercial trade in seeds and other planting materials is allowed; selling seeds of unlisted varieties is illegal. These lists limit farmer access to new varieties from domestic as well as foreign research. Seed varieties are tested and listed for the avowed purpose of protecting farmers from economic loss with underperforming varieties. In other words, governments select technologies. For example, in 1993 the government of Malawi allowed just one private maize hybrid (which is about twenty years old) along with five maize hybrids from government research, whereas the OECD listed more than 400 new maize varieties.

Variety limits on seed imports and domestic trade can have an impact on domestic production and income that dwarfs any impact on seed imports. In Turkey seed trade liberalization and related reforms allowed private companies to introduce hybrid maize varieties in the mid-1980s. Within four years private hybrids had spread to roughly a third of maize-planted areas and national average maize yields had doubled. Research suggests that seed reforms provided Turkish farmers with $100 million a year in additional income from private maize hybrids alone, with gains in other crops (Gisselquist and Pray 1995). The reforms generated a $1 million increase in average net imports of hybrid maize seed during 1983–85, but once the Turkish market for maize hybrids was established, domestically produced seed took over the domestic market and maize seed exports surged. A similar transition occurred roughly a decade earlier in Chile, with hybrid maize seed imports giving way to net exports.

Effective seed trade liberalization—allowing foreign seed to enter and compete within domestic markets—cannot be achieved by simply doing away with import controls. For one thing, phytosanitary controls on foreign pests and diseases will remain even after comprehensive reforms eliminate seed import barriers. Also, government variety lists are often written as limits on domestic seed trade, so import liberalization alone does not remove restrictions that block imports and sales of seed varieties that are new to the country. Aside from

quarantine restrictions, many governments require that imported seed be certified, whereas domestic seed is allowed to be sold without certification.

Governments that want to achieve effective liberalization of seed trade must recognize and communicate with national and international associations of private seed companies, do away with compulsory variety registration, review and revise phytosanitary restrictions to focus more effectively on realistic pest and disease threats, and eliminate other seed import barriers that have nothing to do with disease control.

The private sector and governments have worked together in some prominent cases of rapid commodity production and export expansion (figure 4-5). Success has been due largely to transfers of foreign capital and technology (at least at the initial stage), ranging from material inputs in production (seeds, tractors, chemicals) to transfer of capital into commodity production or processing. Government contributions to these success stories include funding for research and development and physical infrastructure, complementing the role of the private sector.

Developing research and infrastructure

The public sector has a role to play in research, extension, and importation of new technologies. Rapid growth in the cocoa and palm oil exports of Malaysia

and Indonesia and the potential growth of coffee in Uganda (see below) are examples that underscore the importance of research in commodities. The main reason Southeast Asian countries have been competitive in the export of commodities despite rising labor costs is the sharp increase in productivity these countries have achieved through research, extension, and importation of new technologies.

The importance of agricultural research in maintaining competitiveness is illustrated by Malaysia's performance in the palm oil industry. Over the past thirty years the world market for palm oil has grown from 1.3 million tons to 12.2 million tons. In 1961–63 Malaysia and Indonesia together accounted for just 17 percent of world palm oil production. Africa, on the other hand, produced about 75 percent, with Nigeria and Zaire accounting for the majority of African production. By 1992–93 Malaysia's share of world palm oil production had risen to 51 percent while Indonesia's share rose to 24 percent and Africa's share fell to 14 percent. (figure 4-6). The stagnation of African production is due in large part to the destruction and abandonment of palm grove processing mills during the Nigerian civil war.

The surge of palm oil production in Malaysia and Indonesia, on the other hand, is due to high rates of investment in the sector. Malaysia's palm oil industry, for example, is profitable largely because of rapid and sustained gains in yields (even after allowance for some unsustainable elements in production growth). Research efforts—public and private—resulted in the development of planting materials and techniques that were well-suited to the climates of both countries. As an example, production was boosted in 1982 by releasing weevils to improve pollination; as a result oil extraction rates from the palm oil kernel rose by 33 percent. Malaysian growers routinely generate twice as much palm oil per hectare (adjusting for the life cycle of trees) as African producers.

Cotton production in francophone Africa experienced sharp growth as a result of the activities of the semipublic enterprise, *Compagnie française pour le développement des fibres textiles*. In addition to equity participation, the company played a significant role in the provision of research, technical assistance, and consultant services aimed at enhancing productivity. As a result average cotton yields per hectare and the rate of ginning production (the amount of fiber per kilogram of seed cotton) in the region—which includes Benin, Burkina Faso, Côte d'Ivoire, and Mali—are generally higher than those in anglophone Africa.

The importance of the policy environment and the avoidance of unnecessary barriers to technology is evident in the case of coffee in Uganda, which developed hybrid, high-yielding coffee varieties several decades

Governments and foreign firms play important roles in developing country exports

Figure 4-5 Contribution of governments and foreign firms to the development of nontraditional commodity exports
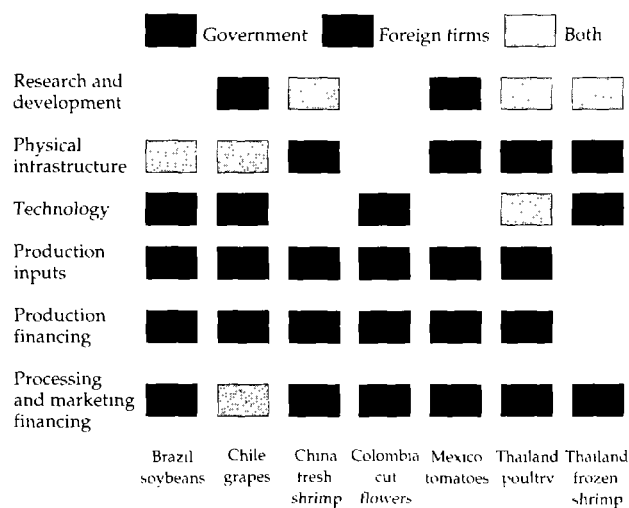
Source: Jaffee 1993.

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Figure 4-6 Palm oil production, selected years, 1961 to 1993

1961/62

Others 8%   Indonesia 10%
Malaysia 7%
Africa 75%

1981/82

Others 9%   Indonesia 14%
Africa 23%
Malaysia 54%

1992/93

Others 11%
Africa 14%   Indonesia 24%
Malaysia 51%
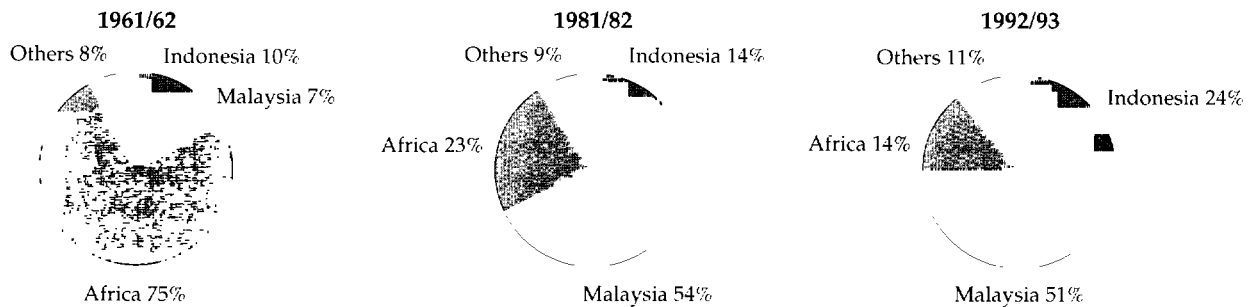
Source: United Nations Food and Agriculture Organization data.

ago. These new varieties were not made available to farmers because of the social and political turmoil that the country was undergoing and because excessive government intervention in the subsector essentially shut out private initiatives. With the recent liberalization of export markets, the private sector has started to play a major role in building nurseries and selling seedlings of high-yielding varieties to farmers.

Another example of strategic development of nontraditional commodities comes from Chile, which has developed a number of new export products including salmon, flounder, forest products, and blackberries. These enterprises are driven by the research, development, production, and marketing efforts of Fundación Chile, an organization funded equally by the Chilean government and the private sector specifically to develop nontraditional exports. Once a new industry is developed, Fundación sells it to the private sector. Because of its success other countries, including Bolivia and Colombia, have imitated this approach.

Finally, the role of the public sector in developing transport and communications infrastructure is evident in a number of areas, as illustrated by the association between slow integrators and poor infrastructure (figure 4-7). Good transport and communications systems have become critical to competitiveness not only in service and manufacturing industries but also in commodity markets. The rapid growth of horticulture exports, for example, in Chile, Colombia, and Kenya would not have been possible without such systems. A recent examination of the cocoa subsector in Indonesia shows that the availability of adequate transport facilities was one of the main reasons for the rapid expansion of cocoa on the island of Sulaweis, where smallholder production of cocoa increased from 18,000 tons in 1984 to 201,000 tons in 1993 (Akiyama and Nishio 1996). Similarly, Chile's commodity exports benefited greatly when the port labor unions were dissolved and port

usage fees declined sharply. Finally, the lack of adequate transport systems to handle bulk goods is one of the main reasons investment in the mining sectors of slow integrators has been concentrated in metals and minerals with high value-weight ratios, such as diamonds and gold.

Promoting financial flexibility

One of the main obstacles to the development of commodity sectors in slow integrators is their weak financial and risk management systems. The poor quality of links to international financial markets is a major signal of this weakness. There is considerable scope for increased use of market-based risk management instruments such as futures, options, and swaps, in commodity-dependent developing countries. Such instruments reduce short-term price uncertainty and increase the predictability of revenues from the commodity exports of governments and private firms. This reduction in uncertainty and increase in predictability is especially important for the long-term viability of private traders in these countries.

In some of these countries many banks and other financial institutions are insolvent, inefficient, or both. As a result real interest rates tend to be extremely high. In these circumstances the warehouse receipt system, which is widely used in industrial countries, could significantly strengthen export and inventory financing for commodities. This system has already been implemented in some developing countries, including Brazil, Indonesia, and Mexico, and is under consideration in Poland and Uganda.

Warehouse receipts are used in industrial countries as secure collateral to obtain financing for commodities. They are often tradable in a secondary market. The use of warehouse receipts is limited in developing countries, however, because of the lack of appro-

Figure 4-7 Infrastructure development in four groups of countries, 1992

Electric power production
Kilowatt hours per person

Telephone main lines per 1,000 people
Number

Paved road density per million people
Kilometers
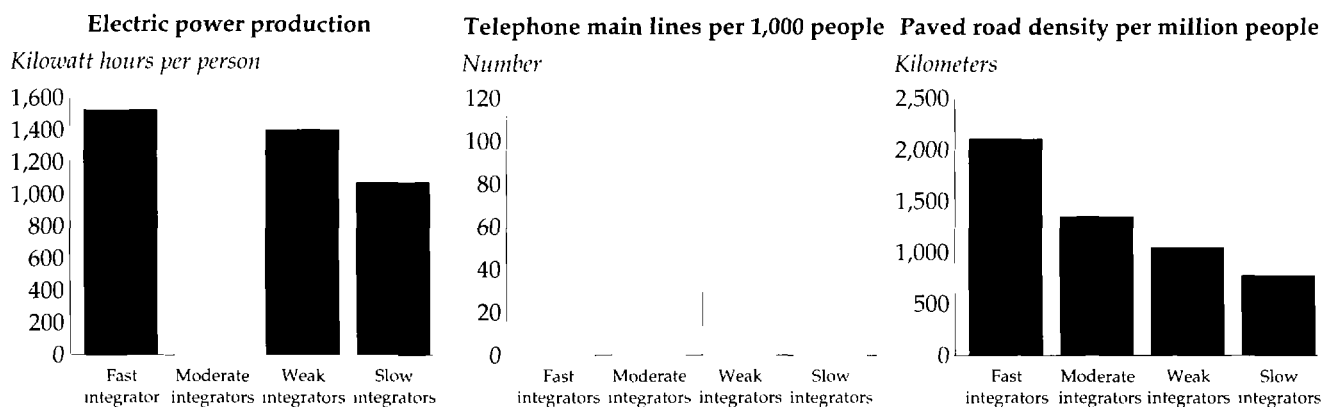
Note: Does not include countries of the former Soviet Union.
Source: World Bank data and staff estimates.

priate legal and institutional frameworks and, in some countries, government policies that crowd out the private sector's incentive to store commodities. For example, government-decreed fixed prices throughout the crop year create a disincentive for farmers to store and sell later. Warehouse receipts offer the alternative of market-based financing of agricultural exports and inventories, especially where prefinancing may be limited by poor creditworthiness.

With warehouse receipt financing, a local buyer with initial working capital makes crop purchases and deposits the crop in a bonded warehouse. The warehouse registers the delivery and issues a receipt that is usually formally registered. The receipt can then be used to obtain credit from local banks. In practice the warehouse itself frequently operates as a bank, entering into repurchase agreements with the local buyers.

Warehouse receipt systems offer a number of benefits to developing countries. First, they provide for a secure collateral to lending institutions. Second, they can form the basis for a developing domestic spot market for countries in the process of market liberalization. Third, warehouse receipts provide an alternative to government involvement in physical markets and thus reduce the direct role of the government in crop commercialization.

Certain conditions are required to establish a warehouse receipt system. For warehouse receipts to be secure collateral, an appropriate legal and institutional environment must guarantee the sanctity of contracts and give priority to the claim in case of lender default. Other preconditions for creating a warehouse receipt

system include the existence of verification and physical controls, a system of warehouse certification, a system for grading, the existence of property and casualty insurance, and provision of performance guarantees by warehouse owners.

Conclusion

The country examples cited in this chapter demonstrate that commodity-dependent countries are not condemned to low productivity and an inability to diversify production and exports. Although the volatility of commodity prices and their decline in real terms pose serious problems, these problems can be overcome by policies that strengthen the private sector (for example, abolition of state monopolies), encourage foreign direct investment (joint ventures in production and export marketing), promote research and its application (minimizing restrictions on new agricultural technology), and develop infrastructure (telecommunications reform). For these policies to be successful they must be complemented by efforts to develop institutional and human resources. While there is no quick fix for the inadequate investment of the past, the potential gains from liberalization of commodity sectors adds urgency to the task.

Note

1. Because of low price and income elasticities and the high concentration of supply among a few producers, expansion of output in these commodities induces stagnant or even falling net revenues for the producers as a whole

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Appendix 1

Regional economic prospects

East Asia

Remarkable export performance and strong investment continued to underpin East Asia's rapid output growth in 1995. For the second year in a row the region's GDP growth exceeded 9 percent, and almost all countries continued to outstrip their respective ten-year trend growth rates. Current estimates suggest that the region's export volumes surged 21 percent over 1994 while imports rose 18 percent. This growth exerted a significant pull on the economies of trading partners both within and outside the region. Rapid growth of world import demand and the competitive boost provided by the yen's appreciation in the first part of 1995 contributed to the region's export success and helped indirectly stimulate investment in export and domestic sectors.

The Chinese economy appears to be achieving a soft landing. Output growth slowed from the 13 percent pace sustained in the three years to 1994 but remained over 10 percent in 1995, and a further mild slowdown is projected in 1996. Consumer price inflation, which peaked at 24 percent in 1994, is estimated to have come down to 17 percent in 1995. Tight monetary policy has, however, complicated the process of improving the financial performance of indebted state-owned enterprises, and this remains an overriding challenge in further reforming the economy. The official forecast for annual GDP growth is 8–9 percent for 1996–2000, while inflation is targeted at less than 10 percent.

The Philippines' recovery continued to progress last year, with output growth estimated to have topped 5 percent for the first time since 1989. Despite weaknesses in agricultural production, investment growth contributed strongly to the advance in output. Nevertheless, the country's domestic savings rate, near 14 percent of GDP, remains less than half that of its Asian neighbors, where savings rates average more than 35 percent of GDP.

To offset the effect of continuous fast growth on inflation the authorities in Indonesia, the Republic of Korea, and Thailand continue to keep a tight grip on money supply. Annual growth averaging more than 8 percent in the 1990s has contributed to escalating wage pressures and widening current account deficits in Malaysia. Nevertheless, consumer price inflation edged downward in these economies in 1995 and is expected to come down further.

Continued high domestic savings and even higher rates of investment are the central assumptions underlying the region's high-growth forecast. Partly because of mounting needs for investments in infrastructure, the regional share of investment in GDP is projected to increase from 36 percent during 1991–94 (already much higher than the developing country average of 25 percent) to more than 40 percent in the next ten years. External financing is expected to amount to about 1.5 percent of GDP ($50 billion a year) in the coming decade, up from the 1980s average of just over 1 percent. Foreign direct investment (FDI), which topped $42 billion in 1994 and has accounted for about half the region's foreign financing in the 1990s, is expected to continue to provide the bulk of these requirements. China has received the lion's share of the region's FDI but Indonesia, Malaysia, Thailand, and Vietnam also attracted substantial inflows. In Indonesia FDI approvals increased fivefold in the two years to 1995 to about $40 billion, partly in response to new foreign investment liberalization measures. The excellent credit ratings of East Asian countries will allow them to tap international bond markets regularly, and the region is also expected to account for the bulk of commercial bank loans to developing countries.

Growth in the region is forecast to slow slightly over the next ten years, though only in line with slowing population growth; per capita incomes are expected to increase by an annual average of 6.9 percent, the same as in 1986–95 (table A1-1). The income advance will be accompanied by further strong progress in countries' integration with global and regional economies (figure A1-1). Various regional and unilateral trade liberalization measures (such as China's recent announcement of planned tariff reduc-

Table A1-1 East Asia forecast summary
(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	8.5	7.9
Consumption per capita	5.6	6.8
GDP per capita	6.9	6.9
Export volume[a]	13.4	10.1
Median inflation[b]	6.8	5.8
Current account/GDP	–0.7	–1.5

a. Goods and nonfactor services.
b. GDP deflator.
Source: World Bank baseline forecast, February 1996.

tions) and growing investment links within the region are expected to continue to fuel intraregional trade, which has advanced at rates in excess of 20 percent a year in current U.S. dollar terms in the 1990s.

There are downside risks to this favorable outlook but they are, on balance, modest. In some countries infrastructure constraints may not be addressed in time, and risks to macroeconomic stability emanating from large budget deficits or overheating might undermine investor confidence. The region's strong competitive position in export markets and its growing reliance on intraregional demand and trade have

made it more resilient (though not impervious) to cyclical shocks emanating from outside the region.

South Asia

Despite political strains countries in South Asia posted respectable growth in 1995. India, which accounts for 80 percent of the region's GDP, continued to draw substantial benefits from the trade and investment liberalization undertaken after the 1991 balance of payments crisis. Helped by favorable monsoons, output growth in the fiscal year to March 1995 reached 6.3 percent and is expected to remain in a 5.5–6.0 percent range in the year to March 1996. Exports in dollar terms grew around 20 percent while manufacturing output growth averaged more than 10 percent in the past two years. In Pakistan growth improved to an estimated 4 percent in the year to June 1995. Political difficulties reduced investor confidence in Bangladesh and held back growth to 4–5 percent. In Sri Lanka continued military operations against Tamil separatists dampened private sector dynamism and held growth to an estimated 5 percent. Inflation edged higher throughout the region except in India, largely a reflection of missed fiscal targets. Pakistan and Sri Lanka did not meet the International Monetary Fund's (IMF) Extended Structural Adjustment Facility criteria to draw on final loan installments and also had the highest inflation in the region, above 10 percent.[1]

Fast-integrating East Asia will post rapid gains in per capita incomes

Figure A1-1 Integration levels and per capita incomes in East Asia, 1970–2005

Real trade/GDP ratio

Index (1970=100)

Real per capita income/OECD per capita income

Index (1970=100)
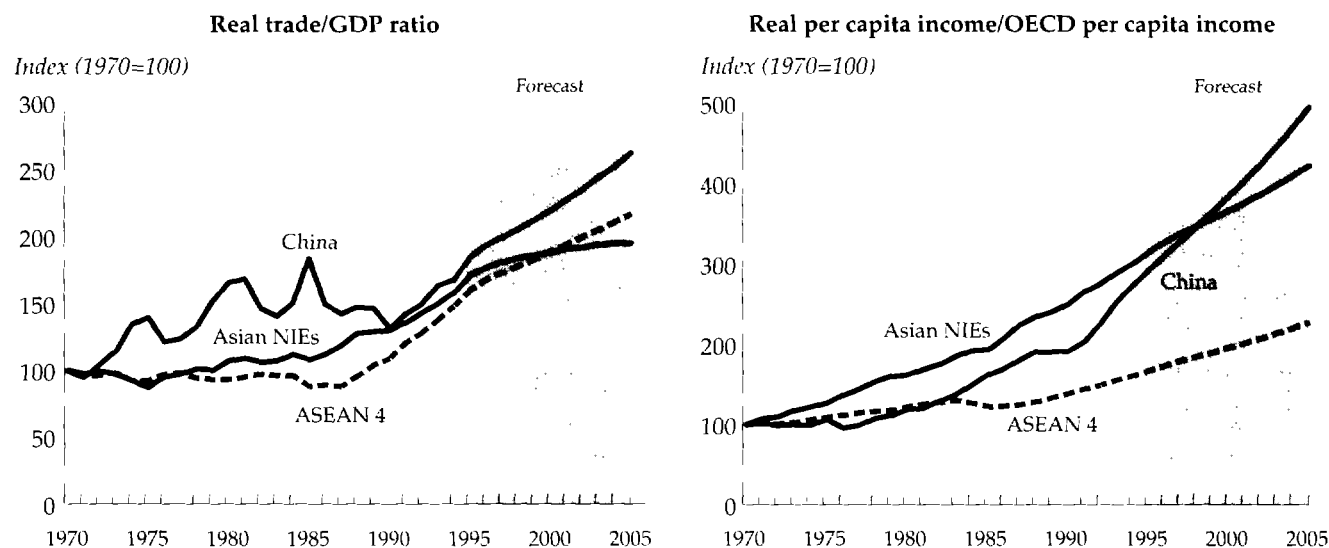
Source: World Bank data and staff projections.

Regional export performance remained vigorous, reflecting trade reforms, exchange rate adjustments, and buoyant world demand. Though liberalization of intraregional trade moved a modest step forward with a preferential regional trade agreement covering 222 items, the short-run impact on exports will be small since only 5 percent of trade is conducted within the region. Portfolio inflows to the region slowed to $2.6 billion in 1995 from a perhaps unsustainable $3.9 billion in 1994. However, the overall level of private capital inflows in 1995 remained at about the same level as in 1994 thanks to a sizable jump in FDI inflows and approvals in India. FDI doubled in each of the past two years to reach an estimated $2.6 billion in fiscal 1995. Aided by buoyant capital inflows, most South Asian countries have replenished their foreign exchange reserves, with India's amounting to several months worth of imports.

Progress on privatization was mixed. The sale of a partial stake in Pakistan Telecommunications contributed to portfolio inflows of $1.1 billion in fiscal 1995, while in India revenues from telecom licensing fees are expected to be substantial. But privatization was delayed in the power sector, and foreign participation in oil exploration was slow to pick up. Privatization of Indian public enterprises is proceeding more slowly than anticipated, and less than 10 percent of the targeted sums have been realized. This slow pace is one reason for the failure to meet fiscal targets.

The long-term outlook for South Asia projects growth averaging 5.4 percent in the next decade, reaching close to 6 percent in the later years (table A1-2). The implied per capita GDP growth of 3.7 percent would represent a substantial improvement both on the past ten years and in terms of poverty reduction. This outlook assumes that the reforms initiated in the early 1990s will be pursued throughout the period. In particular, it is assumed that recent slip-

pages in meeting fiscal deficit targets will be corrected, something that would raise overall savings and investment rates by 4–5 percentage points for the region as a whole. A competitive and stable real exchange rate policy is also assumed to be in place, supporting 7.3 percent real export growth and implying a gradually rising share in world trade.

The external environment for South Asia in the coming decade is expected to be favorable. World trade is expected to grow by nearly 7 percent in the near term and at a little over 6 percent in the longer term. Several sectors of South Asian comparative advantage—clothing, textiles, processed foods, and beverages—are set to expand because of the liberalization under the Uruguay Round. Geographic proximity to the dynamic economies in East Asia will also help trade. Oil prices are expected to fall significantly in 1996–97 and to remain flat in real terms thereafter, reassuring to a region that imports more than half its oil. Private capital flows to developing countries are currently around $160 billion and poised to expand at perhaps 10 percent a year. With South Asia's share of this total currently under 3 percent, there is significant untapped potential for help in financing South Asian growth. The relatively low cost of English-speaking skilled labor throughout the region and the large size of domestic markets in India and Pakistan are some of the main attractions for FDI.

An important downside risk in the projections is that the trend toward lower fiscal deficits that began in 1991 seems to be faltering (figure A1-2). In India slow progress on privatization will contribute to keeping

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A favorable external environment will spur growth in South Asia

Table A1-2 South Asia forecast summary
(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	5.1	5.4
Consumption per capita	2.4	3.1
GDP per capita	2.9	3.7
Export volume[a]	9.2	7.3
Median inflation[b]	9.1	6.4
Current account/GDP	-2.1	-2.3

a. Goods and nonfactor services.
b. GDP deflator
Source: World Bank baseline forecast, February 1996.

Once-falling fiscal deficits are flattening out

Figure A1-2 Budget deficits as a share of GDP in selected South Asian countries, 1991–95

Source: World Bank data and staff estimates.

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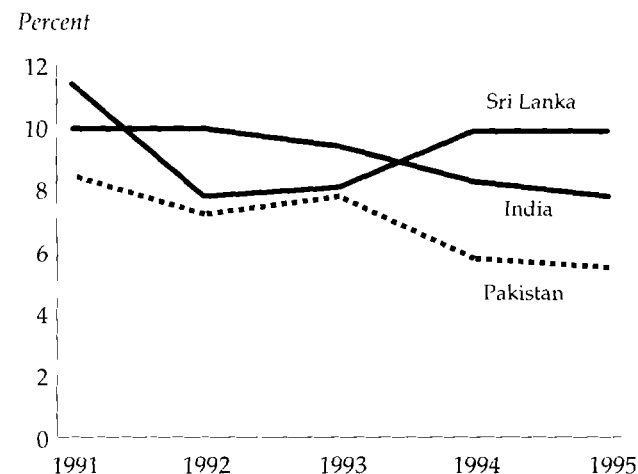
the general government fiscal deficit above 8 percent of GDP in fiscal 1995. In Pakistan poor tax collection, cotton crop failures, and a weak economy kept the budget deficit ratio at 5.6 percent of GDP in 1995. In Sri Lanka military spending kept the fiscal deficit ratio close to 10 percent. Coming after a period of fiscal laxity in the 1980s, the room for maneuver in these countries is limited. As much as a third of government revenue currently goes for interest on debt, underscoring the formidable size of structural fiscal deficits.

A second area of risk is policy toward the private sector, in particular its role in easing infrastructure bottlenecks in such areas as power generation and ports. Given illustrative estimates of infrastructure investment that can reach up to $500 billion over the next ten years and savings rates around 21 percent (compared with 35 percent in East Asia), a positive and credible policy toward FDI is critical. A third area of risk is good governance to enable a business environment conducive to long-term development. Good governance goes beyond maintaining law and order to include transparent rules of the game and public accountability, so that the fruits of development are widely shared. A fourth area of risk or constraint over the long term is the low stock of human capital in South Asia, with average schooling of about three years compared with higher levels in East Asia.

Latin America and the Caribbean

Mexico's balance of payments crisis in December 1994 produced repercussions throughout the region in 1995. Argentina was immediately affected by dwindling private capital inflows in the first half of 1995, as were most countries in the region except Chile and Colombia. In the second half of the year most countries were able to regain access to private capital markets through the issuance of bonds but at much higher spreads—an average of 336 basis points over LIBOR compared with 285 basis points in 1991–94.

The fallout from the financial crisis led to steep recessions in Argentina and Mexico. Output is estimated to have fallen by more than 3 percent in Argentina (where unemployment reached almost 20 percent) and by nearly 7 percent in Mexico. In Brazil output growth slowed to just over 4 percent due to extremely high real interest rates. GDP growth for the region fell from 4.9 percent in 1994 to 0.9 percent in 1995 because of the steep recessions in Argentina and Mexico. Growth slowed in many other countries as well, as indicated by the decline in median growth from 4.1 percent in 1994 to 3.4 percent in 1995. Chile was the only country in the region to experience rapid GDP growth, accelerating from 4.1 percent in 1994 to around 8 percent in 1995.

The growth rate for the region as a whole tends to be dominated by a few large countries—Argentina,

Brazil, Chile, Colombia, Mexico, and Venezuela—and often masks wide disparities in individual country growth rates. Nevertheless, the countries in the region share common characteristics, namely relatively low ratios of domestic savings to GDP (averaging less than 20 percent) and a high concentration of primary commodities in merchandise exports. In recent years tight fiscal and monetary policies coupled with a nominal exchange rate anchor have led to successful stabilization in a number of countries and resulted in a decline in average inflation for the region. In this environment of declining domestic inflation and improved trade prospects (NAFTA, Mercosur), expectations were raised for a higher level of future income. In Argentina and Mexico general government balances moved from deficits of around 2.5 percent of GDP in 1990 to zero by 1994, but overall public sector consumption also rose in both countries. With the fall in private savings these countries' current account balances deteriorated by 4.5–6.0 percentage points of GDP between 1990 and 1994, while real effective exchange rates rose by 68 percent in Argentina and 23 percent in Mexico.

Latin America experienced accelerating inflation from 1970 to the early 1990s, and most countries in the region only began addressing this problem in 1990 (figure A1-3). Median inflation for the region was more than 20 percent a year in 1985–94 with a standard deviation of 12.5 percent compared with rates for East Asia of 6.8 percent a year and a 2 percent standard deviation. A high-inflation, high-volatility environment reflects macroeconomic instability and is not conducive to raising private savings and investment. Now that progress has been made on reducing inflation, macroeconomic stability has improved but remains fragile. Efforts to continue this decelerating trend in inflation will require continued tight fiscal and monetary policies for the rest of the 1990s.

In 1996–97 the region is expected to grow by an average of 2.6 percent a year compared with 3 percent a year in 1991–95. Recovery from the recession in Mexico is expected to be sluggish in 1996 as domestic interest rates remain high to help stabilize the peso and restrain inflation, as well as to reflect the credit constraints caused by the banking crisis. Tight monetary policy aimed at preserving the convertibility plan in Argentina is likely to slow recovery in that country. With Brazil exhibiting a strong commitment to lowering inflation, fiscal slippage in 1995 is likely to be addressed in 1996, while tight monetary policy will continue to slow domestic demand and overall growth. Real coffee prices, especially important for Central American economies, are projected to fall. Terms of trade for the region as a whole are likely to decline 1.5–2.0 percent a year in the short term.

Figure A1-3 Ratios of growth and inflation to GDP in Latin America and the Caribbean, 1970–2005

Percent

Inflation (CPI)
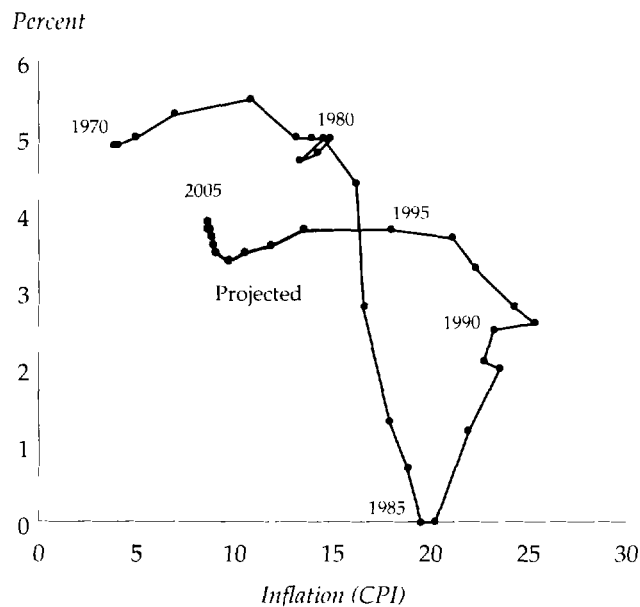
Note: Figures are five-year moving averages.
Source: IMF and World Bank data and World Bank staff projections.

GDP growth is projected to average 3.8 percent a year in 1996–2005, or 2.3 percent on a per capita basis (table A1-3). In the longer term (2001–2005) growth is expected to pick up to 4 percent. This would be a marked improvement over the region's performance of the past fifteen years. Two factors impede even better performance: inflation needs to be reduced further and policies need to be implemented that raise low

The Mexican crisis will not impede long-term recovery

Table A1-3 Latin America and the Caribbean forecast summary

(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	2.4	3.8
Consumption per capita	0.8	1.5
GDP per capita	0.4	2.3
Export volume[a]	6.4	6.1
Median inflation[b]	20.4	8.7
Current account/GDP	–1.7	–1.5

a. Goods and nonfactor services.
b. GDP deflator.
Source: World Bank baseline forecast, February 1996.

savings rates. Ratios of domestic savings to GDP are relatively low for most countries in the region when compared with the average for developing countries. In the wake of the Mexican peso crisis more countries are turning their attention to this problem. Many have started to analyze the benefits of the Chilean model of privatizing pension schemes. But implementing these new policies for raising private savings will take time, and the fruits are unlikely to materialize in the short term. At the same time projections for foreign savings (as measured by the current account deficit) indicate that the annual average will be about $5 billion less than the 1991–95 average. Investment rates are therefore unlikely to rise rapidly over the forecast horizon, and growth will increasingly depend on productivity gains.

Export volumes are projected to grow 6.1 percent a year over the forecast period compared with 6.4 percent in the past ten years. The high concentration of primary commodities in the regional export basket together with a slowing of effective import demand in principal markets (from 7.3 percent a year in 1986–95 to 5.5 percent a year in the next decade) are the main reasons for the slowdown.

Europe and Central Asia

The fall in aggregate output in Europe and Central Asia eased to less than 1 percent in 1995 from 8.5 percent in 1994. The experience of different country groups in the region was, however, quite diverse.[2] Turkey rebounded from its financing difficulties and was buoyed by the recovery in the European Union. Among transition economies, growth in Central and Eastern Europe and the Baltic states accelerated by 1.5 points to 5 percent. Expansion in this group, ranging from some 7 percent in Poland to sluggish gains in Bulgaria and Latvia, continued to be led by the strong performance of exports (which rose some 30 percent in dollar terms), a 20 percent increase in real private investment, and further growth in emerging services sectors. But the diversity of country performance was highlighted by developments in Hungary and the Czech Republic: sharp austerity measures were required in Hungary to stem a potential balance of payments crisis, while the Czech Republic became the first Eastern European country to join the OECD group of industrial economies.

Despite pre-election political uncertainties, economic developments in Russia were largely encouraging during 1995. The output decline slowed to 4 percent after surpassing 12 percent in 1994. Progress in stabilization was apparent as inflation (3.2 percent a month in December) and budget deficits (4.8 percent of GDP) reached postreform lows, while the ruble traded within a narrow band during the second

half of the year. Buoyant exports to markets beyond the republics of the former Soviet Union led to a $18 billion trade surplus and, together with rapid advances in construction and in private and informal sector activity (the latter not fully recorded in official statistics), contributed to the likely bottoming out of GDP. Conditions in Ukraine showed signs of improvement early in the year, but stabilization measures were hampered by difficult relations between the president and parliament, and inflation reaccelerated and GDP fell 15 percent in the year. In Armenia, Georgia, and Moldova the initial results of stronger reform efforts and rising economic activity are becoming evident. Finally, the Central Asian states have continued to exhibit diversity in policy and performance, ranging from stronger results in stabilization for Kazakstan and the Kyrgyz Republic to slippage in Uzbekistan and little progress in Tajikstan and Turkmenistan.

Recent developments underscore the virtuous circle linking stabilization, integration, and growth for the leading reformers among the Central and Eastern European countries. By contrast, conditions akin to a vicious cycle of continued rapid inflation and output losses have afflicted countries that have been slow or lagging reformers (figure A1-4). Among advanced reformers, sound policies implemented over the past few years have fostered an environment that is supportive of private sector activity—especially services—and domestic and foreign investment. Since 1990 the private sector's share of GDP in this group has risen from 20 to 60 percent and private investment from 3.5 to 5.0 percent, while FDI has accumulated to $22 billion (with flows averaging a strong 2 percent of GDP). The improvement in macroeconomic performance has boosted creditworthiness (investment grade ratings were recently granted to the Czech Republic and Poland) and has attracted private capital in increasing amounts. Finally, stabilization has strengthened countries' abilities to liberalize trade and regulatory regimes under EU association agreements and underpinned prospects for eventual membership in the Union. Indeed, integration through trade with the West has progressed rapidly: 60 percent of the region's exports and imports are now traded with EU countries (twice the share in 1990), and links through FDI have strengthened considerably—for example, foreign ventures now account for about 40 percent of Hungary's exports to Western Europe.

Although the Central and Eastern European countries and several states of the former Soviet Union—including Georgia, the Kyrgyz Republic, Moldova, and Russia—have made solid progress in stabilization, and though recovery (or bottoming out) is now more broadly established, the agenda for reform in most transition economies remains large. In some countries

privatization has slowed, banking and financial sectors remain fragile, and issues such as the restructuring of large enterprises, pension system reform, and the provision of safety nets require urgent attention. The buildup of arrears in taxes, wages, and interenterprise debts and accumulation of bad loans in the banking system are symptoms that could undermine the progress achieved thus far and threaten prospects for sustainable growth. For Central and Eastern Europe and the Baltics the goal of EU membership may serve as an important driving force to undertake the second-generation measures needed to move toward Western European norms. It is hoped that as the fruits of stabilization become apparent to today's lagging reformers, a growing political constituency in favor of reform will support more active policy.

Strong exports and private investment are likely to support 4–5 percent growth for the Central and Eastern European countries during 1996—a milestone for Poland, since it means that real incomes will return to pretransition levels (table A1-4). And as the benefits

Leading reformers will continue to gain the most

Figure A1-4 Developments and projections for real GDP, Europe and Central Asia, 1990–2005

Index (1989=100)
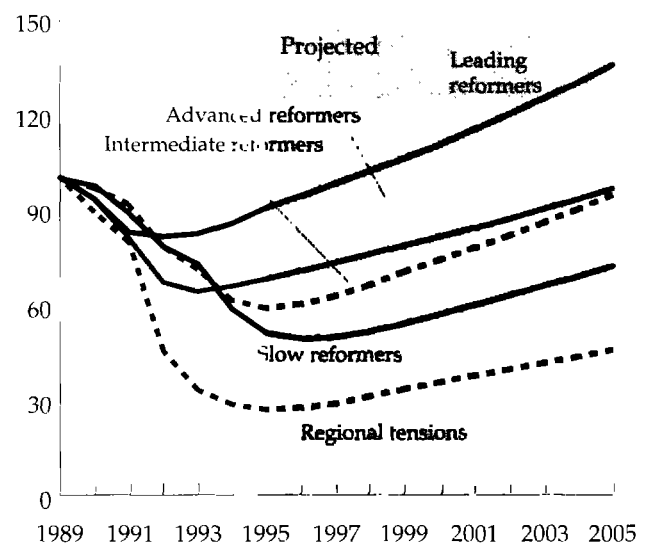
Note: Groupings are based on a system developed in World Bank (forthcoming). Leading reformers include the Czech and Slovak Republics, Hungary, Poland, and Slovenia. Advanced reformers include Albania, Bulgaria, Romania, and the Baltic states. Intermediate reformers include Kazakstan, the Kyrgyz Republic, Moldova, and Russia. Slow reformers include Belarus, Turkmenistan, Ukraine, and Uzbekistan. Countries afflicted by regional tensions include the Transcaucasus and several republics of former Yugoslavia.
Source: World Bank data and staff projections.

of stabilization in Bulgaria and the Baltics materialize more fully, as Hungary emerges from near-term adjustment, and as the war-torn republics of the former Yugoslavia are given respite, regional growth is likely to be maintained near 4 percent in the medium term. Though export growth is strong, import growth with recovery is likely to be stronger still (having risen about 40 percent in dollar terms in 1995) and trade deficits will widen. But these trends should prove sustainable, since private capital continues to be attracted to the region. For a number of countries integration with the European Union could provide support for growth in the longer term—assuming that a foundation of sound structural policies continues to be built over the next few years. This scenario suggests that the leading reformers will have achieved pretransition income levels by 1998, and that by 2005 all the Central and Eastern European countries will have done so.

Despite political and other uncertainties and assuming sustained stabilization efforts, Russia should achieve positive growth in 1996 and Ukraine, in 1997. As in Eastern Europe, a rise in consumer spending may provide the initial impetus for growth. Exports of primary products, supported by the removal of impediments to oil and gas trade, should also contribute to medium-term recovery in Russia. But policy challenges are abundant. For growth to be sustainable in the longer run, domestic and foreign investment will need to be supported by successful stabilization, fiscal reform, and a credible legal and institutional environment. And gains in export rev-

enues will be required to meet debt service obligations. Under a favorable policy scenario for Russia and other republics of the former Soviet Union the current bottoming out of output declines could give way to growth of 3–4 percent by 1997, and to longer-term advances near 5 percent.

Middle East and North Africa

Preliminary estimates indicate a limited upturn to 2.5 percent growth in the Middle East and North Africa region in 1995. In part the improvement can be attributed to somewhat higher growth in the major oil exporters—Algeria, Iran, and Saudi Arabia—tied to a modest increases in oil prices, which averaged 3.5 percent above 1994 levels. But prices weakened significantly in the latter part of 1995, and current projections suggest that oil exporters are likely to face a longer-term trend of gradual erosion in real prices. Real oil prices fell by nearly 8 percent a year in 1981–95. The possibility of a further decline is a significant risk to the long-term forecast, which expects growth in the region to pick up to about 3 percent from 2 percent in 1991–95 (table A1-5). Other key issues affecting the long-run outlook include progress on structural reforms, which up to now has been sporadic at best; greater integration with the world economy, especially in terms of formal arrangements with the European Union; progress in the regional peace process; and institutional development to alleviate high internal sociopolitical tensions.

Regional oil output has been nearly flat in the past few years due mainly to a steady increase in non-OPEC supply. This trend shows little sign of abating in the near future and, in conjunction with high levels of oil stocks and projections for fairly moderate increases in demand, indicates that oil prices may be

Reforms and stability will generate sustainable regional growth

Table A1-4 Europe and Central Asia forecast summary

(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	–3.2	4.3
Consumption per capita	–2.5	3.6
GDP per capita	–3.8	3.7
Export volume[a]	0.7	5.2
Median inflation[b]	25.9	18.1
Current account/GDP	–0.5	–0.5
Memorandum items		
Middle-income		
Western Europe GDP	3.4	3.6
Central and Eastern		
Europe GDP	–1.3	4.1
Former Soviet Union GDP	–5.1	4.6

a. Goods and nonfactor services.
b. GDP deflator.
Source: World Bank baseline forecast, February 1996.

A recovery in growth rests on faster progress on economic and structural reforms

Table A1-5 Middle East and North Africa forecast summary

(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	2.0	2.9
Consumption per capita	–1.0	0.5
GDP per capita	–0.9	0.4
Export volume[a]	6.0	3.8
Median inflation[b]	8.1	6.3
Current account/GDP	–4.2	–1.6

a. Goods and nonfactor services.
b. GDP deflator.
Source: World Bank baseline forecast, February 1996.

subject to significant pressure during 1996–2005. Current projections anticipate declines in real oil prices of 7 percent in 1996 and 5 percent in 1997 before stabilizing in the later years of the forecast period, implying a 1.4 percent annual decline in real prices over the next decade (see chapter 1). These projections represent a considerable worsening of the prospects for oil-producing countries than those in last year's *Global Economic Prospects*, which expected real oil prices to increase by 1.3 a year over the next decade. This year's projections will further tighten the financial constraints on the region's oil-producing countries and are likely to make necessary difficult fiscal and other adjustments. This increasingly less favorable environment implies an urgent need for structural adjustments and reforms.

Economic outcomes in 1995 were also affected by erratic weather-related factors, adding significantly to the volatility of growth. Among the region's more diversified economies (Egypt, Jordan, Morocco, and Tunisia) severe drought contributed to a 5 percent decline in Moroccan GDP while reducing growth in Tunisia. Improved rainfall during the planting season, however, is expected to support a rebound of 7–10 percent in 1996 in both countries. Among the oil exporters better weather conditions and a surge in agricultural output contributed to 3–4 percent growth in Algeria after two years of output declines, a result aided by increased hydrocarbon exports to Europe and some abatement of sociopolitical tensions. Still, longer-term growth performance will require further progress in macroeconomic stabilization and structural reform as well as closer integration with the world economy.

Morocco and Tunisia have signed important economic agreements with the European Union in the context of the Union's Mediterranean Initiative, which aims at closer economic and political links with the southern Mediterranean countries (see chapter 3). Several other countries in the region are expected to sign similar agreements in the near future. In November 1995 representatives from the European Union and the southern Mediterranean countries signed a declaration calling for regular political dialogue, enhanced EU aid, cooperation to control immigration to the Union, and a schedule for the elimination of trade barriers on industrial goods by 2010. The Union also pledged $6 billion in grant aid and another $6 billion in loans for education and infrastructure projects over the next five years. These agreements are expected to lead to an across-the-board trade liberalization in the long run that should lead to export expansion, increased investment, and overall efficiency gains.

Political issues—especially the politics of the Arab-Israeli peace process—will continue to be important.

In 1995 major steps were taken toward the normalization of relations between Israel and individual Arab countries, as well as the Palestinians, but difficult obstacles remain. There was significant progress in Israeli-Palestinian negotiations, but negotiations on the most difficult issues—including water rights and the final status of Jerusalem—are likely to be protracted. And domestic opposition to a lasting peace persists on both sides. A notable development is a significant upturn in tourism in some countries. Reflecting improved perceptions of security, the first five months of 1995 saw the number of tourists to Egypt increase by 24 percent and to Jordan, by 36 percent over the same period in 1994. Syria, which earned $700 million from two million tourists in 1994, expects to have increased its tourism revenues by 14 percent in 1995.

Current projections (which assume the return of Iraq to the world oil market) are for regional GDP to register annual growth of 2.9 percent during the next decade, compared with 2 percent during the past ten years (figure A1-5). As oil export volumes rise by 2.5–3.5 percent over the period, modest regional spillover effects from worker remittances and other income flows should follow. In addition, the emergence of new natural gas pipelines to Europe will significantly boost Algeria's export revenues and help support GDP growth in the range of 4 percent or more,

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Oil prices and GDP growth will remain steady

Figure A1-5 Real oil price and GDP growth in the Middle East and North Africa, 1970–2005

Oil price index ——   —— GDP growth rate
(1975=100)   *(percent)*

Source: World Bank data and staff projections.

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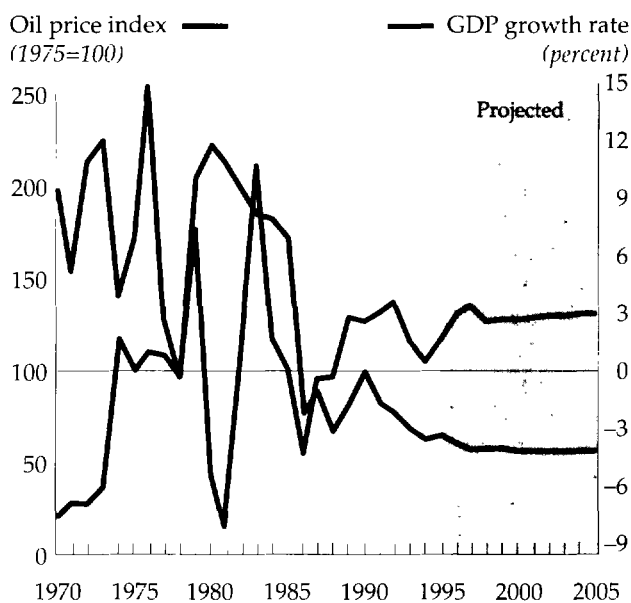
despite political uncertainties. Morocco and Tunisia are best positioned to benefit from the continued strong recovery of EU import demand, both for non-fuel merchandise and for services such as tourism. Although it will take a number of years for the direct effects of the EU's Mediterranean Initiative to become evident, it is hoped that participants' commitments to reform will set the stage for improved competitiveness and higher FDI inflows in the medium term.

Sub-Saharan Africa

Preliminary estimates suggest that regional growth in Sub-Saharan Africa picked up to 3.5–4.0 percent in 1995. If confirmed, this would represent the highest growth so far in the 1990s (growth in 1991–94 averaged 0.7 percent) and the first year of positive per capita GDP growth since 1989. Growth also appears to have been more widespread, exceeding 3 percent in nearly thirty countries. This moderately heartening outcome in a region badly in need of good news was the result of a combination of factors. Some, such as the high commodity prices of the past two years, are likely to be short term in nature. Others, such as better economic policies, political transition in South Africa, and greater civil peace in some areas, ought to be more sustainable.

In South Africa, the region's largest economy, the recovery accompanying the transition from apartheid continued for a second year, with growth rising to nearly 3.5 percent. Capital inflows have increased from low apartheid-era levels, but a large portion appears to be of a short-term and portfolio nature. This probably reflects concerns about relatively high and downwardly rigid unit labor costs and social tensions (as evidenced by rising crime rates). The country is committed to trade liberalization under GATT and the WTO and is considering a free trade agreement with the European Union. If it can come to terms with difficult policy issues aimed at improving labor market flexibility, reducing unemployment, and dealing with social tensions without endangering macroeconomic stability, South Africa has the potential to grow at rates much higher than the current projections of 3–4 percent a year.

But even this modest growth, if it endures, should carry spillover benefits—in part through increased trade and investment flows—for the Southern Africa subregion, the prospects for which have also brightened with movement toward civil peace. Mozambique appears to have settled down to normal economic activity, and the current détente between government and opposition forces in Angola signifies the first time in a generation that the subregion has been without a war. But not all countries in the area enjoyed higher growth: GDP in Zimbabwe fell as a result of drought, which has had a sporadic but serious effect on output over the past decade.

A second main contribution to higher African growth came from the CFA countries in West and Central Africa, which conducted a major realignment of their currencies two years ago. Exports have generally responded well to the boost in competitiveness, and there are clear signs of a rise in intra-CFA trade, primarily through increased imports of coastal countries from the inland. Inflation has been well controlled since the initial pass-through, with eleven of thirteen countries enjoying annual inflation rates of less than 5 percent. The success of the devaluation has varied with the extent to which it was complemented by supporting reforms and adjustments, with the West African group of CFA countries, centered on Côte d'Ivoire, appearing set to benefit most from export-led growth. Countries in the CFA zone also benefited from favorable movements in their commodity export prices over the past two years. Average coffee prices in 1994–95 were more than twice their level in the previous two years, cocoa prices were more than 50 percent higher, and cotton prices were more than 30 percent higher. The small upturn in oil prices early in 1995 was also helpful for several oil exporters.

Prospects for Nigeria, the second largest economy in the region, remain uncertain. The domestic political situation is still volatile, and the country faces the possibility of international sanctions. But oil production rebounded from the strike-induced lows of 1994 and agricultural production also showed some increase. While the country's ability to sustain a recovery is still doubtful, policies pursued in 1995 and the recently announced 1996 budget may provide a foundation for more stable growth and controlled inflation.

High commodity prices also boosted growth in East African nations such as Kenya, Tanzania, and Uganda. Several of these countries, Uganda and Tanzania in particular, are in a position to make significant progress in exchange rate and trade policy reform and the transition to addressing second-generation macroeconomic and fiscal policy issues. Uganda is estimated to have grown by nearly 10 percent in 1995, and if the pace of reforms is maintained is expected to achieve long-term growth rates of more than 5 percent a year.

On balance the largely encouraging developments of 1995 could help set the stage for better medium- and long-term growth prospects. But such projections are dependent on a number of assumptions, important among which are expectations for commodity prices and the region's terms of trade. Sharp declines in terms of trade during 1980–94—averaging almost 4 percent a year—represented an annual loss of income for the subcontinent of 0.8 percent (assuming a ratio of imports to GDP of 20 percent). Although the longer-

term trend decline in primary commodity prices is likely to continue, the pace of decline should moderate, helping to reduce the degree of drag on growth (figure A1-6). Regional terms of trade declines should also slow, to about 1 percent a year. Nevertheless, since the bulk of projected oil and non-oil commodity price declines are projected to occur in 1996, the region's major commodity exporters may face a significant adjustment challenge during this period. Among more favorable external factors are the steady growth paths projected for world trade and for output in industrial countries, including Europe, the region's main trading partner. The forecast also assumes a consolidation of civil peace in subregions where breakthroughs have recently been achieved, such as the Horn of Africa and Southern Africa. Elsewhere, however, the situation remains precarious, as in strife-torn countries such as Burundi, Liberia, Rwanda, and Sierra Leone.

Improvements in policy implementation will be the key determining factor in the longer-term outlook. Over the past decade many countries in the region undertook significant liberalization of exchange rate regimes and trade policy. Non-CFA countries have generally been able to achieve competitiveness through large devaluations in real exchange rates since

the early 1980s, and the successful CFA parity realignment of January 1994 resulted in a real depreciation of about 30 percent after the initial inflation pass-through. Progress has been slower in other key areas, including fiscal policy, public and financial sector reform, and human resource and infrastructure development. The projections here assume that reforms will continue, though at no faster pace than over the past decade. Against this background output growth for the region over the next ten years is anticipated to average 3.8 percent (4.2 percent excluding South Africa and Nigeria), compared with 1.7 percent over 1986–95, and should be underpinned by modest improvements in export performance and domestic investment (table A1-6).

Notes

1. However, in late 1995 Pakistan agreed to a standby arrangement with the IMF.

2. Europe and Central Asia spans a broad range of economies across middle-income Western Europe (Greece, Malta, and Turkey), Eastern and Central Europe, and the states of the former Soviet Union. See the Classifications of Economies tables at the end of this volume.

Investment and terms of trade should improve marginally

Figure A1-6 Sub-Saharan Africa investment/GDP and terms of trade, 1975–2005
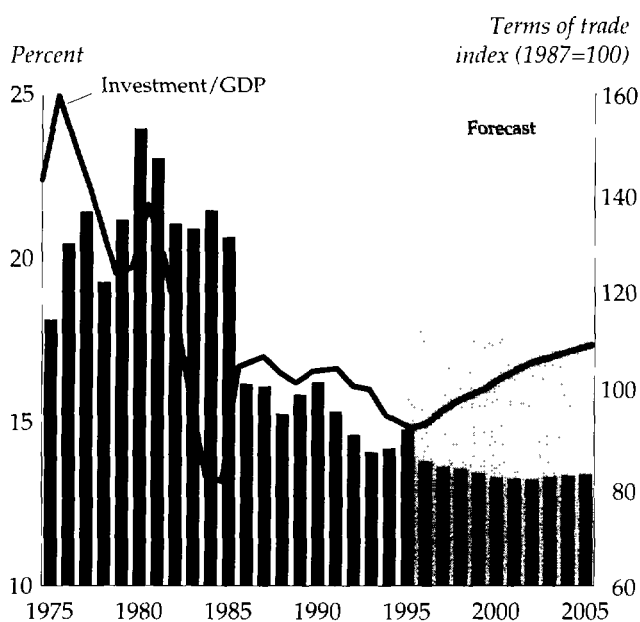
Source: World Bank data and staff projections.

A promising outlook for a struggling region

Table A1-6 Sub-Saharan Africa forecast summary
(percentage annual growth)

Indicator	1986–95	Baseline 1996–2005
GDP	1.7	3.8
Consumption per capita	–1.5	1.2
GDP per capita	–1.2	0.9
Export volume[a]	2.6	4.6
Median inflation[b]	9.6	8.0
Current account/GDP	–1.1	–2.2

a. Goods and nonfactor services.
b. GDP deflator.
Source: World Bank baseline forecast, February 1996.

Appendix 2

The speed of integration index: Qualifications and anomalies

The speed of integration index tabulated in table A2-1 is derived purely from changes in various integration variables between the early 1980s and the early 1990s rather than from the levels of those variables. The interpretation of a particular change, however, often depends on the initial level of integration. For example, most industrial countries already had high levels of the four integration variables (the ratio of real trade to GDP, the ratio of FDI to GDP, *Institutional Investor* credit ratings, and the share of manufactures in exports) in the early 1980s, and a decline in one still left the country at a high level in the early 1990s. Thus despite a small decline in Switzerland's *Institutional Investor* credit rating over the period it had the highest rating in the world, meriting a different interpretation than a similarly sized decline in, say, Congo.

This issue has been partly addressed by treating the industrial countries as a separate category and defining the four quartiles (fast, moderate, weak, and slow) only for developing countries. Nevertheless, it is a major factor influencing some apparent anomalies or counterintuitive placements in the ranking of countries in table A2-1. For example, China is pushed into the group of weak integrators largely because of a decline in its *Institutional Investor* credit rating at the end of the 1980s.[1] But even so, China's rating remained higher than that of all but a handful of developing countries. Another factor restraining China's rating was that, having had a high share of manufactures in exports to start with, the increase in this share was less than for many countries that started with a lower base of manufactures in exports.

Conversely, speed of integration rankings for countries such as Iran and Zimbabwe were boosted because they had large improvements in credit ratings from levels that were exceptionally low at the start of the 1980s (mainly for political reasons), even though ratings remained relatively low in the early 1990s even with this increase. Nepal scored a high overall ranking on the basis of a large increase in its share of manufactures in exports, though from a modest initial level. Zaire attracted little FDI in either the early 1980s or 1990s but did better on this score than countries like Tunisia or Uruguay, where the ratio of FDI to GDP fell over the period even though it was still significant in the early 1990s. Zaire provides an example of a situation where the ratio of trade to GDP rises in a declining economy because exports from a well-protected mineral enclave sector that provides government revenue fall less dramatically than overall GDP. Finally, problems in evaluating trade data for the former members of the Council for Mutual Economic Assistance during the recent period of transition (and assessing comparability with earlier periods) can introduce bias in trade-related measures. The sharp decline in Bulgaria's trade ratio is a case in point.

Table A2-2 presents underlying data for the level of integration index referred to in the text.

Note

1. Without this decline in credit rating China's speed of integration ranking would have been twenty-six places higher, near the top of the moderate integrator group.

Table A2-1 Speed of integration index and underlying indicators

Region/country	Speed of integration index	Change in real trade as a share of GDP 1980–83 to 1990–93	Change in Institutional Investor rating 1983–85 to 1993–95	Change in FDI as a share of GDP 1980–82 to 1990–92	Change in manufacturing export share 1981–83 to 1991–93
High income	**0.31**	**1.33**	**–0.21**	**0.017**	**0.55**
Australia	–0.66	1.02	–1.62	–0.026	1.24
Austria	0.34	1.95	0.35	0.014	0.48
Belgium–Luxembourg	2.24	3.00	0.64	0.384	0.71
Canada	0.54	1.81	–0.42	0.094	1.26
Denmark	0.90	1.13	0.49	0.129	0.88
Finland	0.03	0.43	–0.22	0.018	0.98
France	0.93	0.91	0.79	0.147	0.42
Germany	–0.07	1.30	–0.21	0.015	0.35
Hong Kong	2.29	19.10	–0.22	0.000	–0.12
Ireland	0.59	3.30	0.71	–0.074	1.21
Italy	0.28	1.05	0.46	0.013	0.54
Japan	–0.39	0.24	–0.29	0.003	0.12
Kuwait	–0.47	3.51	–1.54	0.000	0.32
Netherlands	1.14	2.07	0.22	0.146	1.36
New Zealand	–0.61	1.43	–0.67	–0.083	0.56
Norway	–0.53	1.37	–0.77	–0.016	0.12
Singapore	3.52	11.11	0.15	0.367	1.93
Spain	1.07	1.54	1.22	0.099	0.52
Sweden	0.70	1.07	–0.04	0.172	0.54
Switzerland	0.09	0.94	–0.23	0.083	0.17
United Kingdom	0.28	1.02	–0.32	0.055	1.17
United States	–0.28	0.78	–0.69	–0.019	1.04
Low and middle income	**–0.18**	**0.06**	**0.04**	**0.002**	**0.27**
East Asia	**0.77**	**1.37**	**–0.05**	**0.03**	**0.64**
China	–0.29	0.58	–0.86	0.041	0.61
Indonesia	0.81	–1.40	–0.05	0.021	3.81
Korea, Rep. of	0.63	1.37	1.30	0.011	0.26
Malaysia	1.80	5.74	–0.41	0.054	3.80
Myanmar	–0.42	–0.21	–0.08	0.000	–0.06
Papua New Guinea	–0.40	–1.11	–0.73	0.056	0.64
Philippines	0.99	1.84	0.13	0.021	2.69
Taiwan, China	0.77	2.72	0.97	0.028	0.36
Thailand	2.12	3.25	1.03	0.046	3.83
Europe and Central Asia	**0.46**	**1.06**	**0.57**	**0.03**	**0.29**
Bulgaria	–1.73	–6.02	–1.64	0.014	0.64
Czechoslovakia, former	0.46	–0.07	0.57	0.097	0.38
Greece	0.11	3.14	–0.48	0.031	0.29
Hungary	0.95	1.06	–0.18	0.289	0.05
Poland	0.58	2.10	1.57	0.048	–1.05
Portugal	1.89	3.61	1.58	0.150	0.94
Romania	0.25	0.63	0.76	0.011	0.24
Soviet Union, former	–2.23	–0.13	–2.53	0.000	–1.94
Turkey	1.87	1.65	1.54	0.029	3.27

Table A2-1 Speed of integration index and underlying indicators (continued)

Region/country	Speed of integration index	Change in real trade as a share of GDP 1980–83 to 1990–93	Change in Institutional Investor rating 1983–85 to 1993–95	Change in FDI as a share of GDP 1980–82 to 1990–92	Change in manufacturing export share 1981–83 to 1991–93
Latin America and					
the Caribbean	**-0.23**	**0.45**	**0.21**	**0.01**	**0.32**
Argentina	0.59	0.37	0.21	0.141	0.56
Bolivia	0.33	0.69	0.69	0.007	0.58
Brazil	-0.28	0.50	-0.80	-0.042	1.61
Chile	0.65	0.97	1.41	-0.011	0.59
Colombia	-0.54	0.77	-0.98	-0.010	0.59
Costa Rica	0.73	2.82	1.07	0.034	-0.01
Dominican Republic	-0.04	-0.34	0.39	0.037	0.00
Ecuador	-0.52	0.28	-0.69	0.028	-0.02
El Salvador	0.08	-0.26	0.73	0.007	0.22
Guatemala	-0.17	-0.32	0.51	-0.015	0.08
Haiti	-0.37	0.42	-0.21	-0.008	0.10
Honduras	-0.12	-0.52	0.39	0.022	0.04
Jamaica	1.19	3.31	0.54	0.184	0.06
Mexico	1.44	1.62	0.44	0.007	3.85
Nicaragua	-0.28	-0.05	0.22	0.008	-0.22
Panama	-0.74	0.45	-1.48	-0.029	1.11
Paraguay	-0.25	2.36	-0.86	0.028	0.14
Peru	-0.95	-1 41	-1.14	0.01	0.318
Trinidad and Tobago	-0.23	3.12	-2.05	-0.01	2.051
Uruguay	-0.34	1.06	0.19	-0.12	0.674
Venezuela	-0.24	0.26	-0.78	0.04	0.820
Middle East and					
North Africa	**-0.19**	**-0.27**	**-0.39**	**0.00**	**0.180**
Algeria	-1.51	-0.97	-2.27	0.00	0.180
Egypt	-0.19	-1.88	-0.70	-0.04	2.696
Iran	0.20	0.04	1.09	0.00	-0.001
Iraq	-1.68	-4.85	-1.33	0.00	0.000
Israel	0.66	0.73	1.01	0.04	0.674
Jordan	-0.39	2.39	-1.32	-0.02	0.880
Morocco	0.97	0.39	0.57	0.03	2.516
Oman	-1.00	-1.61	0 22	-0.14	0.063
Saudi Arabia	-3.40	1.31	-1.39	-0.62	0.010
Syria	0.42	-1.05	0.23	0.00	2.356
Tunisia	0.16	-0.27	-0 51	-0.08	3.339
United Arab Emirates	-0.18	1.97	-0.27	0.00	0.000
Yemen	-0.79	-1.63	na	-0.01	-0.001
South Asia	**0.87**	**0.05**	**-0.08**	**0.00**	**2.559**
Bangladesh	0.32	0.06	0 61	0.00	1.040
India	0.01	0.09	-0.45	0.00	1.613
Nepal	1.35	0.00	-0.08	0.00	5.112
Pakistan	0.87	0.05	0.63	0.01	2.559
Sri Lanka	0.95	-0.33	-0.25	0.00	4.271

Table A2-1 Speed of integration index and underlying indicators (continued)

Region/country	Speed of integration index	Change in real trade as a share of GDP 1980–83 to 1990–93	Change in Institutional Investor rating 1983–85 to 1993–95	Change in FDI as a share of GDP 1980–82 to 1990–92	Change in manufacturing export share 1981–83 to 1991–93
Sub-Saharan Africa	**–0.46**	**–0.36**	**–0.03**	**0.00**	**0.079**
Angola	–0.70	0.02	–0.19	–0.05	–0.209
Benin	–0.83	–4.53	na	0.00	0.701
Botswana	–0.87	–2.69	0.72	–0.17	0.601
Burkina Faso	–0.17	–0.26	na	–0.01	0.875
Burundi	–0.47	–0.37	na	0.00	0.000
Cameroon	–0.72	1.81	–1.31	–0.10	1.161
Central African Republic	–0.46	–2.38	na	–0.03	1.157
Chad	–0.25	0.83	na	0.01	0.000
Congo	–1.52	–2.83	–0.27	–0.12	–0.383
Côte d'Ivoire	–1.08	–0.75	–1.44	0.01	0.116
Ethiopia	–0.19	–0.11	0.04	0.01	0.317
Gabon	–1.13	–0.20	–0.87	–0.08	–0.063
Ghana	0.56	4.49	0.49	0.00	0.042
Guinea	–0.23	0.19	na	0.02	0.193
Kenya	0.00	–0.27	–0.18	–0.01	1.460
Lesotho	–0.71	–3.28	na	0.00	0.451
Liberia	–1.18	–1.77	–0.42	–0.08	–0.113
Madagascar	–0.12	–1.43	na	0.03	1.107
Malawi	–0.39	–0.35	0.08	0.01	–0.293
Mali	–0.15	1.53	na	–0.01	0.242
Mauritania	–0.68	–1.44	na	–0.03	0.118
Mauritius	2.35	3.82	1.90	0.01	3.478
Niger	–0.73	–1.70	na	–0.02	–0.045
Nigeria	–1.87	–5.59	–1.49	0.00	0.033
Rwanda	–0.07	0.45	na	–0.04	1.340
Senegal	–0.04	–0.46	0.31	–0.01	0.790
Sierra Leone	–1.79	–3.53	–0.10	0.03	–3.057
Somalia	–0.83	–3.37	na	0.02	–0.008
South Africa	–0.79	0.16	–1.84	–0.01	1.350
Sudan	–0.56	–1.01	–0.18	0.00	–0.005
Tanzania	–0.16	–0.65	0.34	0.01	0.225
Togo	–0.43	1.28	na	–0.04	–0.153
Uganda	–0.13	0.24	0.32	0.00	–0.002
Zaire	0.05	1.82	0.23	0.00	0.035
Zambia	–0.56	–2.29	0.13	0.01	0.000
Zimbabwe	0.03	0.31	0.79	0.01	–0.289

na is not available.

Note: Regional values are the median for all countries in the region. Speed of integration index is an average of the standardized scores for the four underlying variables with a mean of 0 and a standard deviation of 1. Changes are in annual averages and for trade, FDI, and manufactures exports are in percentage point terms.

Source: Institutional Investor and World Bank data and staff estimates.

Table A2-2 Initial level of integration index and underlying indicators

Region/country	Initial level of integration index 1981–83	Population-adjusted trade ratio 1981–83	Institutional Investor rating 1981–83	FDI as a share of PPP GDP[a] 1981–83	Manufacturing export share 1981–83
High income	**1.25**	**25.06**	**81.80**	**0.32**	**70.20**
Australia	0.87	–0.17	89.30	1.70	22.00
Austria	1.26	18.51	83.60	0.32	84.47
Belgium-Luxembourg	1.87	77.80	78.07	1.25	74.11
Canada	0.81	19.67	90.53	–0.34	53.68
Denmark	0.79	25.98	71.17	0.18	56.79
Finland	0.96	16.34	75.80	0.13	74.35
France	1.16	18.83	85.10	0.33	73.59
Germany	1.46	25.90	94.73	0.19	86.79
Hong Kong	1.73	79.59	75.13	0.00	96.67
Ireland	1.19	39.27	68.40	0.95	64.47
Italy	1.00	11.13	72.57	0.18	84.07
Japan	1.41	11.82	95.33	0.03	96.71
Kuwait	0.51	52.75	69.20	0.00	19.05
Netherlands	1.60	71.18	87.83	1.07	49.36
New Zealand	0.34	–7.01	75.50	0.83	20.62
Norway	1.35	64.34	87.87	1.16	30.67
Singapore	5.88	295.66	78.23	8.80	56.51
Spain	0.79	–1.60	66.40	0.65	70.62
Sweden	1.24	30.89	80.00	0.29	78.87
Switzerland	1.58	27.97	96.10	0.23	92.51
United Kingdom	1.41	24.21	89.00	1.06	67.39
United States	1.26	10.52	97.23	0.51	69.79
Low and middle income	**–0.45**	**–13.69**	**39.20**	**0.14**	**12.96**
East Asia	**0.40**	**11.70**	**56.02**	**0.12**	**28.89**
China	0.74	14.52	65.60	0.06	70.40
Indonesia	–0.17	11.70	55.73	0.12	4.94
Korea, Rep. of	0.93	23.40	56.30	0.07	90.95
Malaysia	1.10	21.13	72.10	2.58	22.73
Myanmar	–1.02	–17.65	na	0.00	4.52
Papua New Guinea	0.40	4.19	44.17	2.57	8.56
Philippines	–0.04	–6.96	40.10	0.10	48.21
Taiwan, China	1.16	33.20	67.67	0.12	89.14
Thailand	–0.06	–6.72	51.30	0.28	28.89
Europe and Central Asia	**0.32**	**–3.72**	**50.73**	**0.00**	**69.49**
Bulgaria	0.37	8.55	42.80	0.00	71.82
Czechoslovakia, former	0.51	–9.65	50.73	0.00	88.10
Greece	0.47	–8.14	58.77	0.89	51.06
Hungary	0.32	–0.62	51.83	0.00	63.41
Poland	–0.09	–3.72	18.03	0.02	69.49
Portugal	0.49	–9.58	54.93	0.31	73.78
Romania	0.23	6.76	32.60	0.00	72.79
Soviet Union, former	0.28	5.24	63.73	0.00	41.64
Turkey	–0.42	–6.71	17.63	0.07	42.28

Table A2-2 Initial level of integration index and underlying indicators (continued)

Region/country	Initial level of integration index 1981–83	Population-adjusted trade ratio 1981–83	Institutional Investor rating 1981–83	FDI as a share of PPP GDP[a] 1981–83	Manufacturing export share 1981–83
Latin America					
and the Caribbean	**–0.46**	**–20.05**	**40.07**	**0.32**	**14.13**
Argentina	–0.33	–21.49	48.03	0.29	20.09
Bolivia	–1.07	–37.98	16.87	0.42	2.45
Brazil	0.15	–4.14	49.37	0.55	40.28
Chile	–0.23	–13.18	50.17	0.76	7.46
Colombia	–0.10	–20.05	56.67	0.47	24.03
Costa Rica	–0.44	–24.15	23.90	0.75	29.01
Dominican Republic	–0.71	–27.17	23.43	0.32	19.65
Ecuador	–0.60	–20.31	44.23	0.22	2.45
El Salvador	–0.70	–19.92	10.00	0.11	36.79
Guatemala	–0.67	–28.53	17.87	0.47	26.80
Haiti	–0.77	–35.72	na	0.14	41.78
Honduras	–0.87	–17.07	16.40	0.21	9.74
Jamaica	–0.28	2.26	16.43	–0.34	60.54
Mexico	–0.02	–6.58	57.00	0.72	14.13
Nicaragua	–1.23	–36.40	8.23	0.00	8.59
Panama	–0.46	–13.69	40.53	0.34	10.68
Paraguay	–0.61	–31.80	43.53	0.31	9.15
Peru	–0.54	–18.69	39.60	0.14	14.07
Trinidad and Tobago	0.56	7.63	54.57	2.45	10.95
Uruguay	–0.21	–29.90	39.33	0.93	30.78
Venezuela	–0.17	0.77	63.50	0.20	2.02
Middle East and					
North Africa	**–0.06**	**–5.11**	**39.25**	**0.26**	**9.52**
Algeria	–0.36	–0.74	55.93	–0.02	0.67
Egypt	–0.42	–6.37	35.03	0.57	9.52
Iran	–0.95	–5.53	12.93	0.00	3.56
Iraq	–0.06	32.42	39.20	0.00	20.37
Israel	0.52	13.76	36.50	0.26	80.70
Jordan	–0.05	–5.11	39.30	0.28	42.37
Morocco	–0.33	–13.34	34.50	0.16	33.75
Oman	1.01	76.24	46.77	2.51	4.87
Saudi Arabia	2.36	66.04	73.03	6.24	0.81
Syria	–0.81	–20.14	26.13	0.00	11.15
Tunisia	0.38	–7.39	47.07	1.51	39.49
United Arab Emirates	0.29	61.75	60.27	0.00	3.67
Yemen	–0.57	–14.74	na	0.33	0.05
South Asia	**–0.30**	**–12.78**	**25.92**	**0.00**	**53.31**
Bangladesh	–0.30	–12.78	14.25	0.00	63.83
India	0.24	10.22	47.60	0.00	53.31
Nepal	–0.41	–28.50	na	0.00	49.49
Pakistan	–0.20	–8.22	21.53	0.07	58.56
Sri Lanka	–0.53	–21.73	30.30	0.23	25.58

This table continues on the following page.

Table A2-2 Initial level of integration index and underlying indicators (continued)

Region/country	Initial level of integration index 1981–83	Population-adjusted trade ratio 1981–83	Institutional Investor rating 1981–83	FDI as a share of PPP GDP[a] 1981–83	Manufacturing export share 1981–83
Sub-Saharan Africa	**–0.83**	**–20.55**	**18.50**	**0.11**	**7.57**
Angola	–0.45	–17.85	17.20	1.45	12.52
Benin	–0.72	–32.31	na	0.02	30.59
Botswana	0.07	3.28	na	2.37	10.49
Burkina Faso	–0.87	–27.27	na	0.06	12.96
Burundi	–1.05	–32.46	na	0.04	2.29
Cameroon	–0.50	–19.81	34.55	0.83	5.87
Central African Republic	–0.62	–36.35	na	0.32	34.84
Chad	–1.04	–33.70	na	0.00	5.27
Congo	–0.29	16.67	15.73	1.23	7.66
Côte d'Ivoire	–0.38	–2.20	40.20	0.28	10.83
Ethiopia	–1.11	–16.52	9.97	0.01	0.95
Gabon	–0.50	–27.86	35.57	1.08	4.79
Ghana	–1.10	–37.74	na	0.08	0.78
Guinea	–0.89	–29.01	na	0.00	14.27
Kenya	–0.58	–13.69	35.83	0.11	11.68
Lesotho	–0.87	–30.48	na	0.25	10.38
Liberia	–0.77	–20.39	15.23	1.00	1.72
Madagascar	–0.90	–20.72	na	0.00	7.48
Malawi	–0.99	–26.73	20.93	0.04	5.82
Mali	–0.90	–22.27	na	0.11	5.39
Mauritania	–0.66	–8.49	na	0.54	4.57
Mauritius	–0.84	–43.25	19.80	0.03	32.59
Niger	–0.96	–25.56	na	0.16	1.73
Nigeria	–0.01	24.80	50.23	0.63	1.03
Rwanda	–0.75	–34.57	na	0.49	17.85
Senegal	–0.82	–18.30	20.87	0.13	11.64
Sierra Leone	–0.52	–27.82	12.13	0.21	52.69
Somalia	–0.92	–8.42	na	–0.16	0.49
South Africa	0.40	–8.61	59.97	0.09	64.76
Sudan	–1.16	–21.54	10.30	0.00	0.78
Tanzania	–0.91	–14.19	12.83	0.00	13.52
Togo	–0.76	–21.52	na	0.37	9.67
Uganda	–1.22	–19.94	5.23	0.00	0.29
Zaire	–1.13	–18.62	6.13	0.00	5.89
Zambia	–0.92	–4.42	13.20	0.15	0.75
Zimbabwe	–0.50	–14.37	25.43	0.00	34.37

a. PPP is purchasing power parity.

Note: Regional values are the median for all countries in the region. Level of integration index is an average of the standardized scores for the four underlying variables with a mean of 0 and a standard deviation of 1. Population-adjusted trade ratios are residuals from a regression of the ratio of trade to PPP GDP on population. Trade ratios, FDI, and manufactures are in percent terms. Credit ratings are index values.

Source: Institutional Investor and World Bank data and staff estimates.

Appendix 3

Robustness of results

The results in chapter 2 on the relation of pace of integration to growth and various policy measures were tested for robustness with respect to changes in several conditions of the analysis. First, the analysis was repeated using average levels of the integration variables over the past decade rather than changes in them. The composition of the integration index was also tested to see if the results were being dominated by one of its constituent variables by dropping these constituents from the index one at a time. Representative values for the various integration classes were also derived using averages rather than medians. In these various tests, comparing fast integrators with weak and slow integrators taken together, the fast integrators continued to have fiscal deficits that were 1.5 to 5.0 percentage points of GDP smaller and about one standard deviation less volatile than the weak and slow integrators, real exchange rate volatility around 40–50 percent less, annual per-capita GDP growth that was 1–3 percentage points higher, and so on.

The statistical significance of differences between the average values for various integration classes of certain key variables was also tested using analysis of variance (table A3-1). It is possible to reject with 95 percent confidence the hypotheses that fast integrators on the one hand and weak and slow integrators taken together on the other have the same average values for budget deficits, budget deficit volatility, per-capita GDP growth and volatility, and terms of trade changes. The hypotheses suggesting equal means for real exchange rate volatility and tariffs can be rejected at the 90 percent confidence level. (The

relation of real exchange rate volatility to the speed of integration is stronger for the smaller data set of eighty-eight countries for which results are shown in table 2.4. In addition, real exchange volatility is significantly related to elements of the level of integration, as shown in figures 2.6a and 2.6b.) Inflation rates and inflation volatility do not, however, emerge as significantly different in either case because of a small number of extreme observations that inflate variance within groups.

Table A3-1 Summary of analysis of variance

| Variable | Null hypothesis: equal means between (a) fast integrators and (b) weak and slow integrators | |
	F statistic (critical value at 95% level=3.98)	P value
Budget deficit as a share of GDP	5.18	0.0259
Budget deficit volatility	11.27	0.0013
Consumer price inflation	0.68	0.4127
Consumer price volatility	1.05	0.3098
Real exchange rate volatility	3.12	0.0819
Average tariff	3.98	0.0519
Terms of trade change	6.82	0.0111
Per capita real GDP growth	18.53	0.0000
Volatility in per capita GDP growth	11.96	0.0009

Source: World Bank data and staff estimates.

Global Economic Indicators

Table 1 Growth of real GDP, 1966-2005

(current 1994 dollars and 1987 prices and exchange rates—average annual percentage growth)

	1994 GDP (US$ billions)	1966-73	1974-90	1991-94	1994	1995 estimate	1996-2005 forecast
World	**25,677**	**5.1**	**3.0**	**1.5**	**2.9**	**2.8**	**3.5**
High-income	**20,397**	**4.8**	**2.8**	**1.7**	**3.0**	**2.5**	**2.9**
Industrial countries	19,677	4.7	2.7	1.6	2.9	2.4	2.8
G-7 countries	17,174	4.7	2.8	1.6	2.9	2.3	2.8
United States	6,738	3.0	2.6	2.5	4.1	3.2	..
Japan	4,590	10.0	4.0	1.2	0 5	0.4	..
G-4 Europe	5,296	4.4	2.3	0.9	2.9	2.5	..
Germanyᵇ	1,835	4 3	2.0	1.3	2.9	2.1	..
Other industrial	2,500	4.9	2.3	1.2	3 1	3 2	2 7
Other high-income	720	8.8	5 6	6 2	5 9	5 5	5.5
Low- and middle-income	**5,280**	**6.9**	**3.6**	**1.0**	**2.5**	**3.9**	**5.3**
Excluding Eastern Europe and former Soviet Union	4,490	6.2	3.8	5.0	5.5	4 9	5.4
Asia	1,910	5.9	6.8	7 7	8.5	8.2	7.2
East Asia and Pacific	1,520	7.9	7.9	9.4	9.7	9 2	7.9
China	520	8.5	8.7	12.9	12.2	10.2	..
Korea, Rep. of	380	11.2	8.5	6.6	8.0	9.3	..
Indonesia	175	6 4	6.7	7.6	7.3	7 5	..
South Asia	395	3.7	4 9	3 9	5.7	5.5	5.4
India	295	3.7	4.8	3.8	6.1	5.8	.
Latin America and the Caribbean	1,627	6.4	2.6	3.6	4.9	0.9	3.8
Brazil	555	9.8	3.6	2 2	5 8	4.2	..
Mexico	380	6.8	3.4	2.5	3.6	-6.9	.
Argentina	280	4.3	0.5	7.6	7 4	-3.2	..
Europe and Central Asia	1,030	6.9	3.3	-9.0	-8.4	-0.7	4.3
Russian Federationᵇ	380	6.9	3.6	-10.6	-12.6	-4.0	..
Turkey	130	6.1	4.5	3.2	-5.3	5.3	..
Poland	90	7 3	0.2	1 8	5.2	7.0	..
Middle East and North Africa	510	8 6	1.4	2.4	2.1	2.5	2.9
Iran, Islamic Rep.	65	10.2	-0.3	5.2	2 4	2.7	..
Algeria	42	6.3	4.4	-0.6	-1.0	3.5	.
Egypt	43	3.8	7.3	1.1	2.0	2.5	..
Sub-Saharan Africa	278	4.7	2.2	0.7	1.7	3.8	3.8
South Africa	120	4.7	2.1	-0 1	2.4	3.4	..
Nigeria	35	6.5	1.1	2.8	2 5	0.5	..

Note. Growth rates over intervals are computed using least squares method.

a. Data prior to 1991 cover Federal Republic of Germany

b Data prior to 1992 cover former Soviet Union

Source World Bank data and staff estimates

Real GDP growth, 1996-2005

Percent

Table 2 Growth of real GDP per capita, 1966–2005

(current 1994 dollars and 1987 prices and exchange rates—average annual percentage growth)

	1994 GDP per capita (US$)	1966–73	1974–90	1991–94	1994	1995 estimate	1996–2005 forecast
World	**4,560**	**3.0**	**1.2**	**–0.1**	**1.3**	**1.4**	**2.0**
High-income	**23,980**	**3.8**	**2.1**	**1.0**	**2.3**	**1.8**	**2.4**
Industrial countries	24,645	3.8	2.1	0.9	2.3	1.8	2.4
G-7 countries	25,650	3.8	2.2	1 0	2.2	1.6	2 4
United States	25,800	1.9	1.6	1.4	3.0	2.1	..
Japan	36,730	8 7	3.2	1.0	0.2	0.1	.
G-4 Europe	20,770	3.8	2 1	0.5	2 5	2.2	..
Germany[a]	22,445	3.9	2.0	0.7	2.3	1.5	.
Other industrial	19,440	4.0	1.7	0.6	2.5	2.7	2.4
Other high-income	14,900	6.0	3.5	5.1	4.9	4 5	4.4
Low- and middle-income	**1,110**	**4.3**	**1.6**	**–0.7**	**0.8**	**2.3**	**3.7**
Excluding Eastern Europe and former Soviet Union	1,040	3.5	1 7	2.9	3.6	3 2	3.7
Asia	650	3.3	4.9	6.0	6.9	6.7	5.8
East Asia and Pacific	880	5 1	6.2	8 0	8.4	8.0	6 8
China	440	5.7	7.1	11.6	11.0	9.2	..
Korea, Rep. of	8,560	8 8	7 0	5.6	6.9	8.3	.
Indonesia	920	3.9	4.7	5.8	5 7	6.0	..
South Asia	320	1.3	2 7	1.8	3.7	3 6	3.7
India	320	1.4	2.7	1.7	4.3	4.0	..
Latin America and the Caribbean	3,460	3.7	0.4	1 6	2.9	–0.7	2.2
Brazil	3,490	7.1	1.4	0.5	4.0	2 4	..
Mexico	4,240	3.5	0.9	0.4	1.5	–8.7	..
Argentina	8,290	2.7	–0.9	6.1	6.1	–4 3	..
Europe and Central Asia	2,110	5 8	2 3	–9.3	–8.7	–0.8	3.7
Russian Federation[b]	2,540	5.9	2.8	–10.6	–12.0	–3.3	..
Turkey	2,150	3.5	2 1	1.2	–7.2	3.3	.
Poland	2,370	6 5	–0.6	1.6	5.1	6.9	..
Middle East and North Africa	1,600	5.7	–1.8	–0 3	–0.3	0.1	0.4
Iran, Islamic Rep.	1,010	7.0	–4 0	2.4	–0 1	0 4	.
Algeria	1,550	3.3	1 3	–2.9	–3.2	1.2	..
Egypt	750	1.7	4.7	–1.0	0 0	0.5	..
Sub-Saharan Africa	490	2.0	–0.7	–2.2	–1.4	1.1	0.9
South Africa	2,970	2.1	–0.5	–2.4	0.1	1.2	..
Nigeria	330	3.8	–1.7	–0.1	–0.3	–1.8	..

Note: Growth rates over intervals are computed using least squares method.
a Data prior to 1991 cover Federal Republic of Germany
b. Data prior to 1992 cover former Soviet Union
Source. World Bank data and staff estimates

Real per capita GDP growth, 1996–2005

Percent

77

Table 3 Inflation: GDP deflators, 1966-2005
(1987=100; percentage change)

	1966-73	1974-90	1991-94	1994	1995 estimate	1996-2005 forecast
World	**5.0**	**7.6**	**4.0**	**3.0**	**3.2**	**3.5**
High-income[a]	**5.4**	**6.6**	**2.7**	**1.8**	**2.3**	**2.8**
Industrial countries	5.4	6.4	2.7	1 7	2 2	2.7
G-7 countries	5 3	6.1	2.6	1.6	2 1	2.7
United States	4.9	6.0	2.4	2.1	2.0	..
Japan	5 8	3.3	1.1	0.1	0.6	.
G-4 Europe	5.4	8.1	4.0	2.3	3 1	.
Germany[b]	4.9	3.5	4.5	2.3	2.9	.
Other industrial	5.8	7.8	3.0	2 4	2.7	2.6
Other high-income	5.1	18.3	5 4	4 4	4.7	5 0
Low- and middle-income[a]	**4.5**	**10.7**	**11.5**	**15.8**	**10.1**	**8.5**
Excluding Eastern Europe and former Soviet Union	4 5	10.9	10.9	15.2	9.3	7.5
Asia	5 6	8.4	9.5	6.6	8 9	5.5
East Asia and Pacific	5.4	7.4	6 8	6.1	8 6	5.8
China	-1 7	3 8	10.8	16.3	12 7	.
Korea, Rep of	14 3	12.1	6.3	5.5	4 7	.
Indonesia	65.6	13 3	7.4	6 6	8.9	..
South Asia	5.8	8.5	10.1	10.4	9.0	6.4
India	6.2	8.1	10 1	10.5	9.0	.
Latin America and the Caribbean	5.1	18.0	20.0	15 9	11.1	8.7
Brazil	22 8	145.0	1232.0	2284.0	90 1	..
Mexico	5.9	47.5	13.1	7 3	55 7	..
Argentina	24 0	255.0	27.6	1.8	1 3	..
Europe and Central Asia	2 4	5.1	54 0	41.1	38.6	18.1
Russian Federation[c]	2 7	13 7	512.0	320.0	190 0	.
Turkey	10.8	46 2	71.7	106 7	82.3	..
Poland	1.2	31 4	36.4	26 8	28.4	.
Middle East and North Africa	4.2	9 6	5.1	4 6	5.9	6 3
Iran, Islamic Rep.	5 6	16.9	30.3	35.4	46.1	..
Algeria	4 5	10.5	27.1	27.9	24.1	..
Egypt	2.2	11.3	14 9	8.2	7.3	..
Sub-Saharan Africa	4 1	10.1	9 4	23.4	9.7	8.0
South Africa	6.4	14.5	11 9	10.3	10 2	..
Nigeria	10 7	14.5	36.8	37.0	47.1	..

Note: Deflators are in local currency units. Growth rates over intervals are computed using least squares method

a High-income group inflation rates are GDP-weighted averages of local currency inflation, low- and middle-income group rates are medians.

b Data prior to 1991 cover West Germany.

c Data prior to 1992 cover former Soviet Union

Source: World Bank data and staff estimates

GDP inflation, 1996-2005
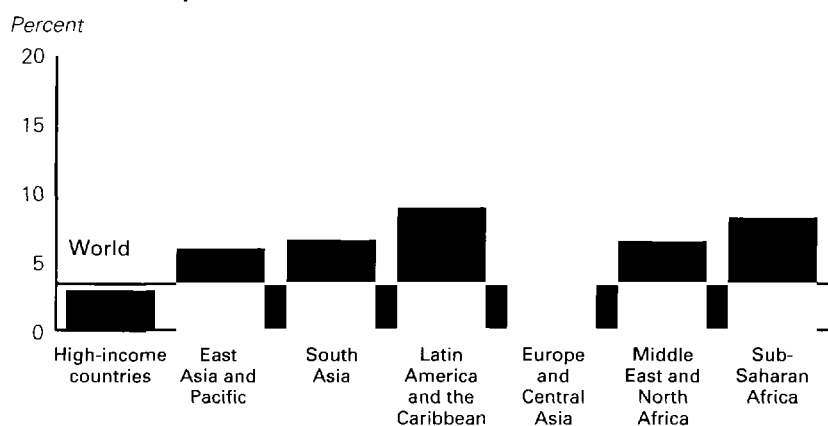
Percent

Table 4 Current account balance, 1970–2005
(percentage of GDP)

	1994 current account balance (US$ billions)	1970–80	1981–90	1991–94	1994	1995 estimate	1996–2005 forecast
World	**–82.0**	**0.0**	**–0.6**	**–0.4**	**–0.3**	**–0.3**	**–0.1**
High-income	**8.5**	**0.1**	**–0.3**	**0.0**	**0.0**	**0.0**	**0.5**
Industrial countries	–12.0	–0.1	–0.5	–0.1	–0.1	–0.1	0.4
G-7 countries	–40.5	0.1	–0 5	–0.2	–0.2	–0.3	0.2
United States	–151.0	0.0	–2.1	–1.3	–2.3	–2.4	.
Japan	129 0	0.6	2.3	2.8	2.8	2 2	..
G-4 Europe	–1 4	0.2	0.3	–0.7	0.0	0.1	..
Germany[a]	–21.7	0.6	2.4	–1.0	–1.1	–0.8	.
Other industrial	28.5	–1 0	–0.7	0.4	1.1	1.4	1 6
Other high income	20 5	9.0	9.6	2.6	3.5	2 5	1.4
Low- and middle-income	**–90.4**	**–0.4**	**–1.4**	**–2.1**	**–1.9**	**–1.5**	**–1.4**
Excluding Eastern Europe and former Soviet Union	–84.6	–0.5	–2.0	–2 3	–1.9	–1 6	–1.6
Asia	–22.0	–1.2	–1 6	–1.4	–1.2	–1.4	–1 6
East Asia and Pacific	–18 8	–1 3	–1 2	–1.4	–1.3	–1.3	–1.5
China	7.2	–0.4	0.1	0.9	1.4	2.6	..
Korea, Rep. of	–5.3	–5.3	0 6	–1 4	–1.4	–1 9	.
Indonesia	–3.8	–1 2	–3 1	–2.2	–2.2	–3.5	.
South Asia	–3 2	–0.9	–2.4	–1.2	–0.8	–1 9	–2.3
India	–1 3	–0.1	–2.2	–0.7	–0.4	–1.7	..
Latin America and the Caribbean	–46 6	–2 5	–1.7	–2.6	–3.0	–1.8	–1.6
Brazil	–1 9	–4.0	–1.5	0.2	–0.3	–2.4	..
Mexico	–28 9	–2.4	–1 0	–6 6	–7.7	–0.2	..
Argentina	–10.0	–0.3	–2.1	–2.4	–3.6	–1.3	.
Europe and Central Asia	–4 1	–0 5	–0.1	–1.1	–0.6	–0.6	–0.5
Russian Federation[b]	0.1	0.1	0 2	0 2	0 0	0 4	..
Turkey	3.1	–2.2	–1 6	–0.4	2.4	1.5	.
Poland	–0.5	–3 9	–1.4	–1.8	–0.6	–0 3	..
Middle East and North Africa	–15.6	7.2	–2.7	–5.7	–3.1	–1.7	–1.6
Iran, Islamic, Rep.	2.6	5 2	–0 4	–3.4	1.3	1.5	..
Algeria	–1.8	–4.7	–0.5	0.9	–4 4	–7.5	..
Egypt	0 2	–4.9	–4.6	4 8	0.5	–3.0	..
Sub-Saharan Africa	–2 1	–1.6	–2.4	–1.4	–0.8	–2.7	–2.2
South Africa	–0.4	–1.5	0.6	1.1	–0.3	–1.7	..
Nigeria	1 6	0.6	0 0	4 7	4.5	–1.0	..

Note: Shares over intervals are period averages
a. Data prior to 1991 cover Federal Republic of Germany
b. Data prior to 1992 cover former Soviet Union
Source World Bank data and staff estimates

Ratio of current account balance to GDP, 1996–2005
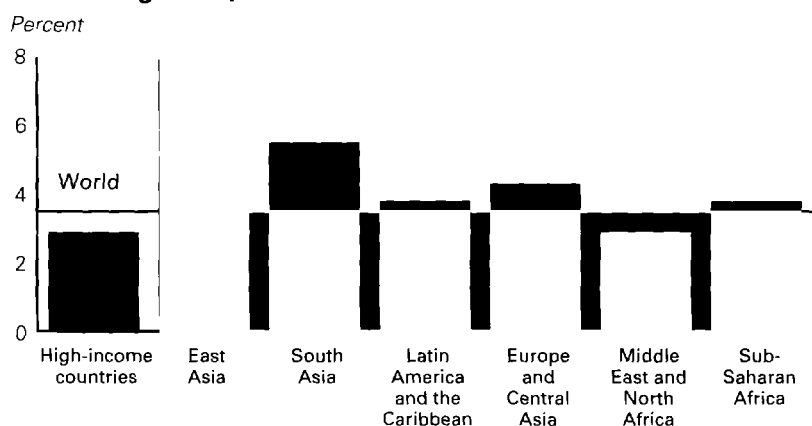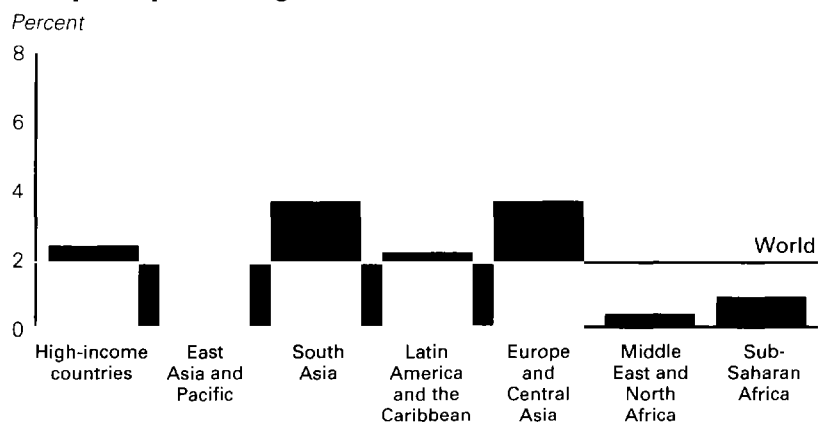
Percent

High-income countries / East Asia and Pacific / South Asia / Latin America and the Caribbean / Europe and Central Asia / Middle East and North Africa / Sub-Saharan Africa
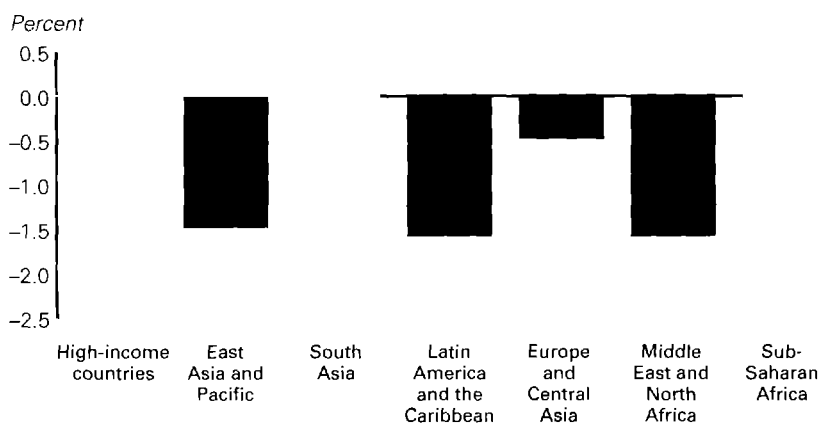
Table 5 Exports of goods, 1994

(percent)

Region/ country	Merchandise exports (US$ millions)	Average annual growth 1981–93	Effective market growth 1981–93
World	**4,237,696**	**5.4**	**4.9**
All developing	**946,558**	**5.3**	**5.0**
Asia	**427,305**	**10.8**	**6.5**
East Asia and Pacific	388,383	11.2	6.7
China	121,047	11.5	7.8
Indonesia	40,054	8.6	6.2
Korea, Rep of	96,000	11.2	6.1
Malaysia	58,756	13.2	7.1
Myanmar	771	0.5	
Papua New Guinea	2,640	6.9	5.3
Philippines	13,304	4.3	6.2
Thailand	45,262	16.6	6.0
Vietnam	3,770		
South Asia	**38,922**	**7.5**	**4.7**
Bangladesh	2,661	8.8	4.9
India	25,000	7.1	4.3
Nepal	363	9.7	5.1
Pakistan	7,370	10.1	5.4
Sri Lanka	3,210	8.2	6.1
Latin America and the Caribbean	**182,201**	**5.0**	**5.4**
Argentina	15,839	3.0	4.7
Bolivia	1,032	2.9	5.4
Brazil	43,600	4.7	5.2
Chile	11,539	7.0	5.1
Colombia	8,399	12.2	5.0
Costa Rica	2,215	6.2	5.2
Dominican Republic	633	-5.1	6.2
Ecuador	3,820	3.8	5.6
El Salvador	844	-1.5	4.7
Guatemala	1,522	0.5	5.5
Jamaica	1,192	2.6	4.9
Mexico	61,964	10.6	6.3
Panama	584	4.9	4.1
Paraguay	817	9.1	4.4
Peru	4,555	-0.3	5.3
Trinidad and Tobago	1,867	-1.3	5.0
Uruguay	1,913	1.9	4.6
Venezuela	15,480	2.8	5.9
Europe and Central Asia	**181,246**	**2.1**	**1.2**
Armenia	43		.
Azerbaijan	366		
Belarus	968	.	.
Europe and Central Asia (continued)			
Bulgaria	4,165	-11.7	-1.5
Czech Republic	14,252		
Estonia	1,299		
Georgia	90		
Greece	9,384	6.4	3.6
Hungary	10,733	0.8	0.6
Kazakstan	1,100		
Kyrgyz Republic	116		
Latvia	972		
Lithuania	2,040		.
Moldova	144		
Poland	17,000	4.6	1.0
Romania	6,151	-11.2	1.3
Russian Federation	64,912		
Slovak Republic	6,587		
Slovenia	6,828		.
Tajikistan	320		
Turkmenistan	382		
Turkey	18,106	6.6	4.8
Ukraine	4,570		
Uzbekistan	944		.
Middle East and North Africa	**96,741**	**1.2**	**5.4**
Algeria	8,594	2.9	4.6
Bahrain	3,454	3.9	6.1
Egypt	3463	0.9	3.6
Iran, Islamic Rep	13,900	8.7	4.6
Iraq	500	-20.3	4.6
Jordan	1,424	4.8	12.2
Morocco	4,013	4.3	4.3
Oman	5,418	11.7	7.0
Saudi Arabia	38,600	-0.8	5.9
Syrian Arab Rep	3,547	8.3	2.4
Tunisia	4,660	8.0	4.2
Yemen, Rep	667	1.5	10.3
Sub-Saharan Africa	**59,065**	**2.4**	**4.6**
Angola	3,550	11.5	4.7
Botswana	1,845	6.5	3.1
Côte d'Ivoire	2,652	1.4	3.8
Cameroon	2,062	8.7	4.4
Ethiopia	372	-3.5	3.4
Gabon	2,252	2.6	4.5
Ghana	1,298	6.0	3.8
Kenya	1,609	4.9	1.8
Madagascar	277	0.7	4.9
Sub-Saharan Africa (continued)			
Nigeria	9,378	2.3	5.7
Senegal	914	1.9	3.7
South Africa	25,000	1.4	4.5
Sudan	465	-3.8	5.9
Zambia	1,071	-1.1	4.9
Zimbabwe	1,260	0.7	3.8
High-income	**3,291,137**	**5.4**	**4.8**
Industrial	2,891,953	4.9	4.8
G-7	2,133,929	4.6	5.1
Canada	166,000	5.2	6.1
France	235,905	4.4	4.2
Germany	427,219	4.0	3.8
Italy	189,805	4.3	4.0
Japan	397,000	4.0	6.6
United Kingdom	205,000	4.3	4.3
United States	513,000	5.9	5.7
Other industrial	758,024	5.5	4.0
Australia	47,538	6.8	6.2
Austria	45,200	7.0	3.3
Belgium and Luxembourg	137,394	4.6	3.7
Denmark	41,417	4.7	3.4
Finland	29,700	2.2	3.0
Iceland	1,620	2.1	3.8
Ireland	34,370	9.4	4.2
Netherlands	155,554	4.9	3.8
New Zealand	12,200	3.9	5.7
Norway	34,700	7.5	3.6
Portugal	17,540	10.6	3.8
Spain	73,300	7.1	4.1
Sweden	61,292	3.3	3.8
Switzerland	66,200	6.2	4.5
Other high-income	399,184	10.1	4.9
Brunei	2,124	-0.8	.
Cyprus	967	4.7	4.1
Hong Kong	151,395	16.3	6.7
Israel	16,881	5.9	5.1
Kuwait	11,614	-4.9	5.8
Qatar	2,942	1.5	
Singapore	96,800	13.3	6.8
Taiwan, China	92,847	9.8	
United Arab Emirates	19,700	7.3	5.9

Note· Trade data for countries of the former Soviet Union (FSU) refer to trade with non-FSU countries only. Growth rates over intervals are computed using least squares method. Growth of industrial country exports covers 1981–94.
Source. See technical notes.

Merchandise exports as share of GDP, 1994

Percent

Chart showing bars for: High-income countries, East Asia and Pacific, South Asia, Latin America and the Caribbean, Europe and Central Asia, Middle East and North Africa, Sub-Saharan Africa. World reference line near 18.
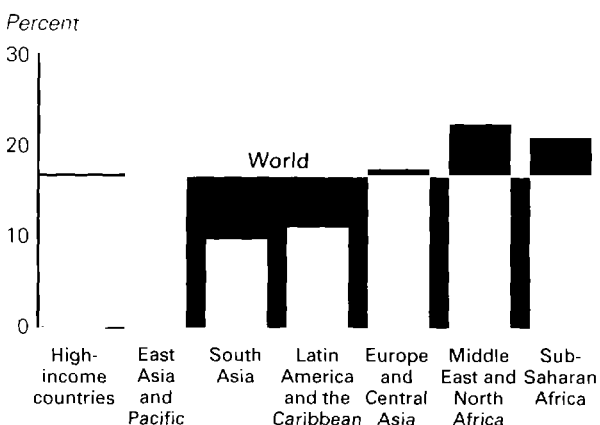
Average annual growth of exports, 1981–93

Percent

Chart showing bars for: High-income countries, East Asia and Pacific, South Asia, Latin America and the Caribbean, Europe and Central Asia, Middle East and North Africa, Sub-Saharan Africa. World reference line near 5.
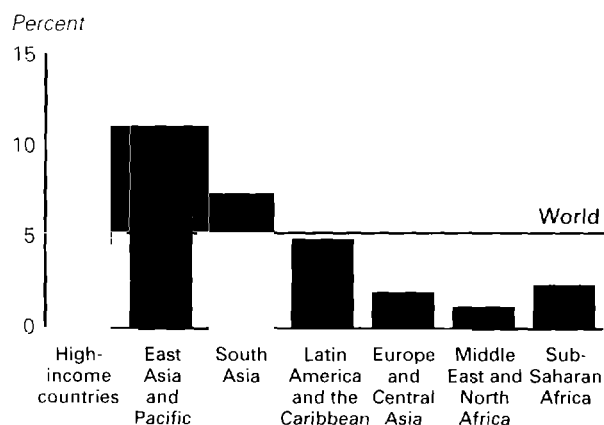
Table 6 Imports of goods, 1994

(percentage growth)

Region/country	Merchandise imports (US$ millions)	Average annual growth 1981–93	Merchandise imports/ GDP
World	**4,317,548**	**5.6**	**17.1**
All developing	**1,010,283**	**3.4**	**19.1**
Asia	**451,874**	**8.7**	**23.6**
East Asia and			
Pacific	**404,292**	**9.8**	**26.6**
China	115,681	9.8	22 2
Indonesia	31,985	4.0	18 3
Korea, Rep of	102,348	11.3	27 2
Malaysia	59,581	10.2	84 4
Myanmar	886	2 3	1 2
Papua New Guinea	1,521	–0.1	28 1
Philippines	22,546	6.4	35.1
Thailand	54,459	15.4	38 0
Vietnam	4,440		28.5
South Asia	**47,582**	**3.4**	**12.0**
Bangladesh	4,701	1.9	18.0
India	26,846	4.0	9.1
Nepal	1,176	4.4	29.1
Pakistan	8,890	3.3	17.1
Sri Lanka	4,780	4.7	40.8
Latin America and			
the Caribbean	**212,638**	**3.4**	**13.1**
Argentina	21,527	3.1	7.6
Bolivia	1,209	1 0	22.0
Brazil	36,000	1 8	6.5
Chile	11,800	6 6	22.7
Colombia	11,883	0.7	17.7
Costa Rica	3,025	6 4	36.5
Dominican Republic	2,630	3 1	25 3
Ecuador	3,690	–1 1	22.3
El Salvador	2,250	3.7	27.7
Guatemala	2,604	3 3	20 2
Jamaica	2,164	2.5	51 0
Mexico	80,100	11 9	21 2
Panama	2,404	0 3	34.5
Paraguay	2,370	7 8	30 3
Peru	6,794	1.2	13 6
Trinidad and Tobago	1,131	–7.8	23 6
Uruguay	2,770	4.6	17 8
Venezuela	7,710	–2 8	13 2
Europe and			
Central Asia	**175,134**	**5.0**	**17.0**
Armenia	120	.	4 6
Azerbaijan	296	.	8.1
Belarus	534	.	2 6

Region/country	Merchandise imports (US$ millions)	Average annual growth 1981–93	Merchandise imports/ GDP
Europe and Central Asia (continued)			
Bulgaria	4,160	–10.8	40.8
Czech Republic	15,636		43.4
Estonia	1,660		36.3
Georgia	200		9.3
Greece	21,466	7 9	27.6
Hungary	14,438	0.8	34.9
Kazakstan	514		2.8
Kyrgyz Republic	92		3.4
Latvia	1,170		20.1
Lithuania	2,353		45.0
Moldova	174		4.7
Poland	21,400	5 4	23 1
Romania	7,109	–1 6	23.6
Russian Federation	28,200	.	7.5
Slovak Republic	6,823	.	55 2
Slovenia	7,304	.	52.0
Tajikistan	318	.	15.4
Turkmenistan	304	.	.
Turkey	23,270	10 7	17 8
Ukraine	2,610		3 2
Uzbekistan	1,150		5 3
Middle East			
and North Africa	**107,306**	**–4.1**	**25.2**
Algeria	8,000	–5 8	19 1
Bahrain	3,737	0 5	82 2
Egypt	10,185	–3 9	23 7
Iran, Islamic Rep	20,000	1 2	31 4
Iraq	2,000	–27 1	..
Jordan	3,382	–2 5	55 4
Morocco	7,188	4 2	23 3
Oman	3,915	0 4	33 7
Saudi Arabia	22,796	–5 6	19 4
Syrian Arab Rep.	5,369	–5 6	.
Tunisia	6,580	4.0	41 7
Yemen, Rep	2,835	–4 9	50 6
Sub-Saharan			
Africa	**63,330**	**–1.5**	**22.9**
Angola	1,300	1 1	18 9
Botswana	1,638	8 4	40 8
Cote d'Ivoire	2,000	–3.4	29 8
Cameroon	1,100	–2 9	14 7
Ethiopia	1,033	–2 7	22 0
Gabon	737	–2.6	18 7
Ghana	1,729	5.2	31.9
Kenya	2,156	0.3	31 4

Region/country	Merchandise imports (US$ millions)	Average annual growth 1981–93	Merchandise imports/ GDP
Sub-Saharan Africa (continued)			
Madagascar	434	–2 0	22 6
Nigeria	6,511	–10.1	18 5
Senegal	1,411	1.6	36 4
South Africa	23,400	0 2	19 2
Sudan	1,269	–4 5	22 0
Zambia	501	–2 5	14 4
Zimbabwe	1,585	–0 3	29 2
High-income	**3,307,266**	**6.2**	**16.6**
Industrial	2,860,366	5.8	14.8
G–7	2,126,850	6 0	12 7
Canada	155,072	6 0	28 6
France	230,203	5 2	17 3
Germany	381,890	6 2	18 7
Italy	167,685	5 4	16.4
Japan	275,000	6 8	6 0
United Kingdom	227,000	5.4	22 3
United States	690,000	6.2	10 4
Other industrial	733,516	5.3	27 8
Australia	53,400	4.3	16 1
Austria	55,300	6 5	28 1
Belgium and			
Luxembourg	125,762	4.4	55 3
Denmark	34,800	3.6	23 8
Finland	23,200	2 3	23 7
Iceland	1,470	1.1	23 7
Ireland	25,508	5.3	49 0
Netherlands	139,795	4.9	42.4
New Zealand	11,900	4.3	23 4
Norway	27,300	3.2	24 9
Portugal	26,680	10.5	30 6
Spain	92,500	11.5	19.2
Sweden	51,800	3.8	26 4
Switzerland	64,100	3.0	24 6
Other high-			
income	446,900	10.3	71.3
Brunei	1,712	3.4	44.0
Cyprus	3,020	7 0	42.0
Hong Kong	162,000	12 4	122.8
Israel	25,237	5 7	32.4
Kuwait	21,716	–5 2	89.4
Qatar	2,051	–1 1	26.8
Singapore	103,000	10 0	149.4
Taiwan, China	85,507	14 1	35.5
United Arab			
Emirates	21,100	3 9	57.1

Note. Trade data for countries of the former Soviet Union (FSU) refer to trade with non-FSU countries only Growth rates over intervals are computed using least squares method. Growth of industrial country imports covers 1981–1994

Source See technical notes.

Merchandise imports as share of GDP, 1994
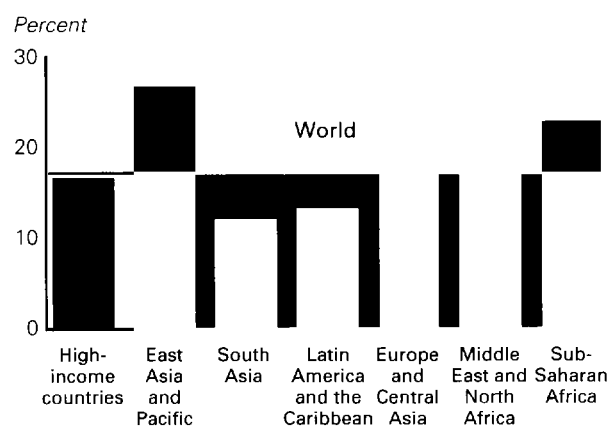
Percent

Average annual growth of imports, 1981–93
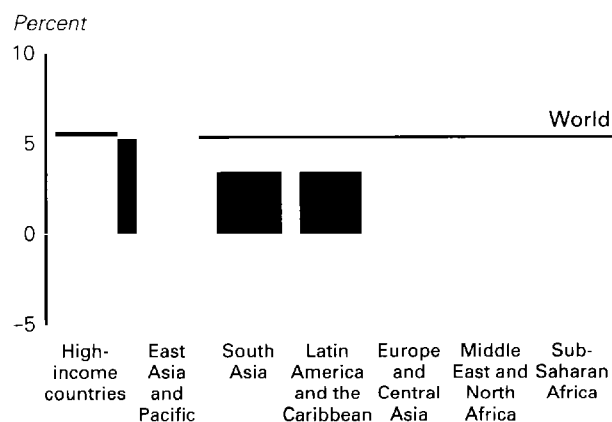
Percent

Table 7 Direction of merchandise trade, 1994

(percentage of world trade)

Source of exports	Industrial importers					Developing importers						World
	United States	European Union	Japan	Other indus-trial	All indus-trial	Africa	Asia	Developing Europe	Middle East	Western hemi-sphere	All developing	
Industrial countries	9.2	29.7	2.6	6.3	47.8	1.3	9.4	2.6	2.1	3.8	19.3	67.7
United States	..	2.6	1.3	3 2	7.0	0.2	2.2	0 2	0.4	2 2	5.2	12.2
European Union (15)	2 9	23.6	0.8	2 4	29 7	1 0	2.6	2 3	1.3	1 0	8.1	38.3
Japan	2.8	1 5	..	0.5	4 8	0.1	3.8	0 1	0.3	0 4	4.7	9.4
Other industrial	3.5	2.1	0.6	0.3	6.4	0 1	0.9	0 1	0.1	0 2	1.3	7 8
Developing countries	6.6	7.1	3.2	1.2	18.1	0.6	8.5	1.8	1.0	1.5	13.3	32.3
Africa	0 3	0 9	0 1	0.1	1.3	0 2	0.1	0.0	0.0	0 0	0.4	2.0
Asia	3.9	2 7	2 3	0 7	9.5	0 2	7.1	0.3	0.5	0.4	8.5	18.2
Developing Europe	0.2	1.9	0.1	0.1	2.3	0.0	0 3	1.4	0.1	0.0	1.9	4.2
Middle East	0 4	0.8	0 6	0.1	1.9	0 1	0.8	0.1	0.2	0.1	1 3	3 5
Western Hemisphere	1 9	0.8	0.2	0.2	3.1	0.0	0.3	0.0	0.1	0.9	1.3	4.4
World	15.9	36.8	5.8	7.5	65.9	1.9	17.9	4.5	3.1	5.3	32.6	100.0

Note. Table based on IMF income and geographic classifications Percentages may not sum to totals, given unallocated and miscellaneous trade flows
Source. IMF Direction of Trade Statistics.

Share of merchandise imports from developing countries, 1994

Direction of merchandise exports, 1994

Industrial to industrial (48%)

Developing to industrial (19%)
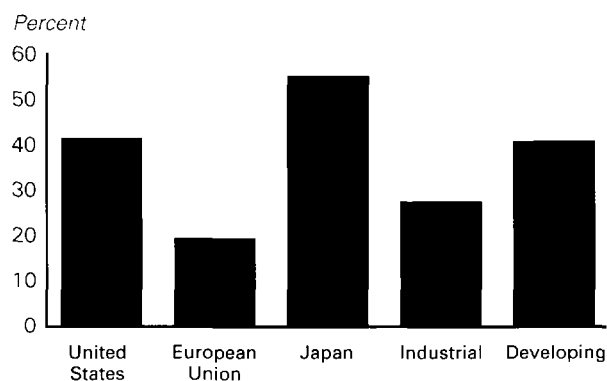
Industrial to developing (19%)

Developing to developing (14%)
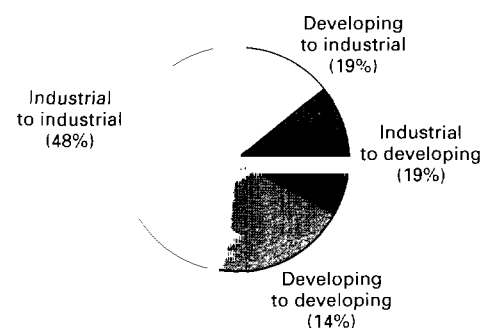
Table 8 Growth of merchandise trade in nominal dollars, 1983–94

(average annual percentage growth)

Source of exports	Industrial importers					Developing importers						World
	United States	European Union	Japan	Other indus-trial	All indus-trial	Africa	Asia	Developing Europe	Middle East	Western hemi-sphere	All developing	
Industrial countries	8.8	8.6	9.5	8.7	8.7	2.2	12.9	8.5	-0.2	11.1	8.4	8.6
United States	.	7.1	8.5	10 0	8.5	1.1	11 3	6.7	1.1	12 4	9 5	8.9
European Union (15)	8.5	8.9	14.4	7.8	8.9	2 3	14.4	10.1	0.2	10 0	7 3	8.5
Japan	9 6	10.1	..	5.9	9.3	3.3	13.3	-2.4	-4 0	10 6	9.7	9.4
Other industrial	8 5	7.2	7 1	9.7	8.0	1 4	11.5	0 6	0.8	5 5	7.1	7.5
Developing countries	9.3	6.1	6.2	8.4	7.3	5.3	14.9	3.5	1.4	8.2	10.4	8.1
Africa	1.5	1.7	0.8	3.2	1 7	8.4	10.7	-1.3	6.0	1 9	6.8	2.5
Asia	12.7	15.2	10.5	12.2	12 7	8.9	18.2	8.4	3.8	16.4	15.6	14.0
Developing Europe	14.5	7 0	4.8	9.6	7.5	-3.8	9.2	4.4	-3.0	6.1	7.4	5.4
Middle East	3.9	-1.3	-1.1	1.6	-0 3	2 5	3.9	-3 0	1.4	-6 2	1.5	0.9
Western Hemisphere	7.0	3 9	4.8	4 6	5.8	-0.6	11.1	-6 5	-3.0	9.6	6.8	5.9
World	9.0	8.1	7.5	8.6	8.3	3.0	13.7	5.9	0.2	10.2	9.1	8.4

Note Table based on IMF income and geographic classifications, growth rates are compound averages.
Source IMF Direction of Trade Statistics

Table 9 Structure of long-term public and publicly guaranteed (PPG) debt, 1994

(percentage of long-term PPG debt)

	Con-cessional	Nonconcessional Variable	Nonconcessional Fixed		Con-cessional	Nonconcessional Variable	Nonconcessional Fixed		Con-cessional	Nonconcessional Variable	Nonconcessional Fixed
All developing	**29.2**	**33.9**	**36.9**	**Europe and Central Asia**	**11.9**	**50.2**	**37.9**	**Sub-Saharan Africa**	**47.1**	**13.2**	**39.6**
Asia	**46.5**	**20.5**	**32.9**	Armenia	24 9	72 9	2.2	Angola	16 4	3.7	79 9
East Asia and Pacific	**37.8**	**23.5**	**38.6**	Azerbaijan	0 0	100 0	0.0	Botswana	45 0	15.7	39 3
China	18 9	26.7	54 3	Belarus	41.9	50.7	7.4	Côte d'Ivoire	29.9	48 2	21 9
Indonesia	45 2	30 4	24.4	Bulgaria	0.1	77.1	22 7	Cameroon	44 6	14 0	41.4
Korea, Rep. of	18 3	21 5	60 2	Czech Republic	1.4	48 2	50 4	Ethiopia	83 1	2.0	15.0
Malaysia	24 3	26 3	49.4	Estonia	44.6	44 6	10 8	Gabon	15 7	15 8	68.5
Myanmar	92.8	0.0	7 2	Georgia	0.1	87.3	12 6	Ghana	82 7	0.6	16.6
Papua New Guinea	52 1	25.7	22 1	Greece	.		.	Kenya	63 2	6.1	30.7
Philippines	38.0	28 8	33 2	Hungary	1.5	33.8	64.7	Madagascar	62 1	8 1	29.8
Thailand	41 2	15.2	43 6	Kazakstan	0.1	99.0	0 9	Nigeria	4.8	18 5	76.8
Vietnam	92 3	3 1	4.6	Kyrgyz Republic	30 1	66.3	3 6	Senegal	74.6	7 2	18.2
South Asia	**64.2**	**14.5**	**21.4**	Latvia	57 7	35.2	7 1	South Africa	.	..	
Bangladesh	98.3	0 2	1.5	Lithuania	36 5	24.8	38.7	Sudan	50.7	15 5	33.8
India	54 2	17 2	28.6	Moldova	25.2	73.7	1 1	Zambia	66.2	6 1	27 7
Nepal	97 1	0.0	2.9	Poland	27.4	58.7	13 8	Zimbabwe	44 1	17 6	38.3
Pakistan	67 5	18.5	13.9	Romania	8 2	57.0	34 8				
Sri Lanka	91.5	3 2	5.3	Russian Federation	8 2	55 5	36 2				
Latin America and the Caribbean	**9.6**	**46.8**	**43.6**	Slovak Republic	2 6	35.5	61 8				
Argentina	4.4	45 3	50.3	Slovenia	2 7	69.6	27 7				
Bolivia	59.8	12.0	28.2	Tajikistan	4 1	95 0	0 9				
Brazil	2.8	59.9	37 3	Turkmenistan	6 0	83.1	10 9				
Chile	3.5	65.7	30.8	Turkey	16 7	25.4	57 9				
Colombia	7.4	47.8	44 8	Ukraine	1 3	96 6	2 2				
Costa Rica	29.4	21.7	48 9	Uzbekistan	16 5	81 9	1 6				
Dominican Republic	52.7	27.0	20.3	**Middle East and North Africa**	**38.6**	**34.5**	**26.9**				
Ecuador	17 4	57.9	24 7	Algeria	7 2	50 9	42.0				
El Salvador	55 2	17.6	27 2	Bahrain		.					
Guatemala	50.2	16.3	33 5	Egypt	64.7	4 2	31.2				
Jamaica	38.5	26.9	34 7	Iran, Islamic Rep	1.0	95 2	3.8				
Mexico	2 1	39.4	58 5	Iraq		.					
Panama	11 3	67.1	21.6	Jordan	41 3	28 6	30 1				
Paraguay	56 6	7 5	35 9	Morocco	27.1	50 3	22.6				
Peru	29 2	37.9	32 9	Oman	20.0	52.2	27.8				
Trinidad and Tobago	3.5	56.3	40 2	Saudi Arabia		.					
Uruguay	6 8	52.0	41.2	Syrian Arab Rep	88.3	0 0	11.7				
Venezuela	1 9	53 0	45 1	Tunisia	37.6	24.4	37 9				
				Yemen, Rep.	63.5	1.5	35 0				

Source. World Bank data

Ten highest ratios of non-concessional debt to GDP, 1994

(percent)
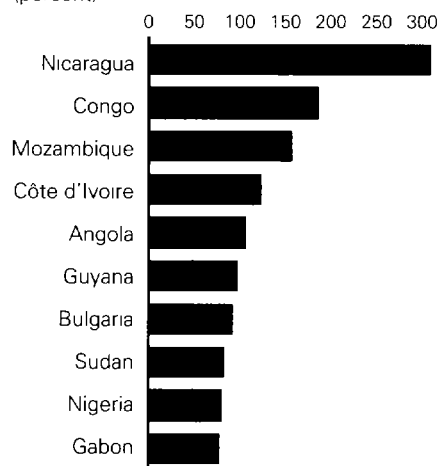
Structure of long-term PPG debt, by group, 1994

Percent

Severely indebted low-income / Moderately indebted low-income / Severely indebted middle-income / Moderately indebted middle-income / Other

■ Fixed rate ▨ Variable rate ▨ Concessional

Structure of long-term PPG debt, by region, 1994

Percent

East Asia and Pacific / South Asia / Latin America and the Caribbean / Europe and Central Asia / Middle East and North Africa / Sub-Saharan Africa

■ Fixed rate ■ Variable rate ▨ Concessional

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Table 10 Long-term net resource flows to developing countries, 1994

(US$ millions)

			Private				Official		
	Total	Percentage of GDP	Total	Net debt flows	FDI	Portfolio equity flows	Total	Official development assistance	Other
All developing countries	**207,402**	**3.93**	**158,789**	**43,775**	**80,120**	**34,894**	**48,614**	**47,416**	**1,198**
Asia	**99,067**	**5.17**	**84,704**	**21,590**	**44,279**	**18,835**	**14,362**	**12,668**	**1,694**
East Asia and Pacific	85,267	5.61	77,289	21,639	43,037	12,613	7,978	6,794	1,184
China	50,004	9.58	46,555	8,853	33,787	3,915	3,449	1,918	1,530
Indonesia	9,093	5.21	7,408	1,627	2,109	3,672	1,685	1,570	115
Korea, Rep. of	7,445	1 98	8,132	4,798	809	2,525	−687	−240	−447
Malaysia	6,882	9 74	6,661	993	4,348	1,320	221	208	13
Myanmar	148	0.20	34	1	4	29	114	115	−1
Papua New Guinea	−23	−0 42	−231	−235	4	0	208	224	−16
Philippines	4,552	7.09	4,107	1,700	1,000	1,407	445	614	−168
Thailand	4,612	3.22	4,138	4,036	640	−538	474	357	117
Vietnam	1,014	6 51	272	−111	100	283	741	687	55
South Asia	**13,800**	**3.49**	**7,415**	**−49**	**1,242**	**6,222**	**6,384**	**5,874**	**510**
Bangladesh	1,536	5.87	47	−11	11	47	1,489	1,498	−9
India	7,085	2.41	5,497	149	620	4,729	1,588	1,234	354
Nepal	329	8.12	−3	−10	7	0	332	335	−3
Pakistan	3,341	6.42	1,657	−108	430	1,335	1,684	1,505	180
Sri Lanka	661	5 65	213	−66	166	112	449	460	−11
Latin America and the Caribbean	**51,127**	**3.15**	**49,669**	**15,698**	**20,811**	**13,160**	**1,458**	**4,133**	**−2,675**
Argentina	8,975	3.18	8,214	5,809	1,200	1,205	761	246	516
Bolivia	480	8 73	−5	−25	20	0	486	424	62
Brazil	9,824	1.77	11,871	3,717	3,072	5,082	−2,047	−57	−1,990
Chile	4,118	7.93	4,300	1,638	1,795	867	−182	61	−243
Colombia	1,518	2.26	1,860	590	950	320	−342	260	−602
Costa Rica	28	0.33	29	−62	87	4	−1	14	−15
Dominican Republic	100	0.96	113	−107	220	0	−13	5	−18
Ecuador	822	4.97	705	171	531	4	117	135	−18
El Salvador	158	1.94	−40	−60	20	0	198	134	64
Guatemala	240	1.86	84	46	38	0	156	113	43
Jamaica	75	1.77	123	6	117	0	−48	71	−119
Mexico	16,817	4.46	17,394	4,895	7,978	4,521	−576	162	−739
Panama	560	8.02	633	−31	549	115	−73	8	−81
Paraguay	181	2.31	135	−45	180	0	46	36	10
Peru	3,770	7.53	3,214	−88	2,326	977	556	382	173
Trinidad and Tobago	391	8.17	343	−173	516	0	48	12	36
Uruguay	508	3.27	378	183	170	25	130	87	43
Venezuela	482	0 83	70	−735	764	42	411	152	259
Europe and Central Asia	**26,777**	**2.60**	**15,581**	**5,285**	**8,362**	**1,934**	**11,196**	**9,249**	**1,947**
Armenia	182	6.99	0	0	0	0	182	151	31
Azerbaijan	134	3.67	0	0	0	0	134	66	68
Belarus	334	1 64	105	90	15	0	229	107	121
Bulgaria	7	0.07	−376	−487	105	6	383	112	271
Czech Republic	2,795	7.76	2,642	1,650	878	114	152	132	20
Estonia	253	5.53	211	−13	214	10	42	24	19
Georgia	188	8.76	10	10	0	0	178	102	77
Hungary	2,912	7.04	2,717	1,233	1,144	340	195	254	−58
Kazakstan	792	4 32	394	209	185	0	398	25	373
Kyrgyz Republic	160	5.88	10	0	10	0	150	126	24
Latvia	302	5.19	222	8	214	0	80	49	31
Lithuania	95	1.82	13	−18	31	0	82	68	14
Moldova	189	5.07	23	0	23	0	166	87	79
Poland	3,473	3 75	1,244	−636	1,875	5	2,229	1,631	598
Romania	1,278	4.25	787	371	340	76	491	126	365

	Total	Percentage of GDP	Private				Official		
			Total	Net debt flows	FDI	Portfolio equity flows	Total	Official development assistance	Other
Russian Federation	2,819	0.75	658	−613	1,000	271	2,162	1,767	395
Slovak Republic	810	6.55	577	374	203	0	233	119	114
Slovenia	336	2.39	368	284	84	0	−32	9	−41
Tajikistan	237	11.46	10	0	10	0	227	45	182
Turkmenistan	57	..	13	13	0	0	45	16	29
Turkey	1,234	0.94	1,530	−137	608	1,059	−295	235	−530
Ukraine	736	0 89	424	174	250	0	313	236	77
Uzbekistan	37	0.17	52	2	50	0	−15	12	−27
Middle East and North Africa	**10,296**	**2.42**	**4,110**	**323**	**3,681**	**106**	**6,186**	**5,882**	**304**
Algeria	1,385	3 30	424	401	18	5	961	503	458
Egypt, Arab Rep.	2,623	6.11	1,006	−260	1,256	10	1,617	1,613	5
Iran, Islamic Rep.	−1,277	−2.00	−1,579	−1,569	−10	0	302	164	138
Jordan	255	4.18	−159	−162	3	0	415	417	−2
Morocco	1,154	3.75	877	213	601	63	277	585	−308
Oman	451	3.88	395	238	130	26	57	73	−17
Syrian Arab Rep.	331	2.12	50	−26	76	0	281	342	−61
Tunisia	422	2 68	80	−114	194	0	342	83	258
Yemen, Rep.	131	2.33	12	−5	17	0	119	101	17
Sub–Saharan Africa	**20,136**	**5.10**	**4,725**	**878**	**2,987**	**860**	**15,411**	**15,482**	**−71**
Angola	736	10.72	409	59	350	0	328	337	−9
Botswana	−18	−0.45	−50	−2	−48	0	32	57	−25
Côte d'Ivoire	1,525	22.70	30	6	17	7	1,495	1,383	112
Cameroon	648	8.68	59	−46	105	0	589	632	−43
Ethiopia	841	17 94	−13	−20	7	0	853	849	4
Gabon	80	2 04	−128	−25	−103	0	209	192	16
Ghana	1,286	23.73	838	48	233	557	448	473	−25
Kenya	106	1.54	−272	−276	4	0	378	508	−131
Madagascar	224	11 66	2	−4	6	0	222	225	−4
Nigeria	1,871	5.32	1,885	−91	1,959	17	−14	−113	99
Senegal	512	13.19	−9	−9	0	0	521	531	−10
Sudan	370	6.42	0	0	0	0	370	370	0
Zambia	475	13.64	−4	−64	60	0	479	544	−65
Zimbabwe	340	6.26	−70	−155	35	50	410	391	19

Source. World Bank data.

Distribution of long-term net resource flows, 1994

Percent   ▓ **Official** ■ **Private**

(Chart x-axis categories: East Asia and Pacific, South Asia, Latin America and the Caribbean, Europe and Central Asia, Middle East and North Africa, Sub-Saharan Africa)
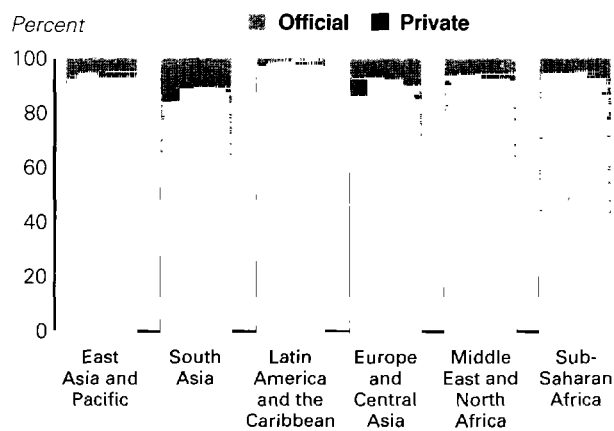
Change in share of private long-term flows, 1990–94

Percentage points

(Chart x-axis categories: East Asia and Pacific, South Asia, Latin America and the Caribbean, Europe and Central Asia, Middle East and North Africa, Sub-Saharan Africa)
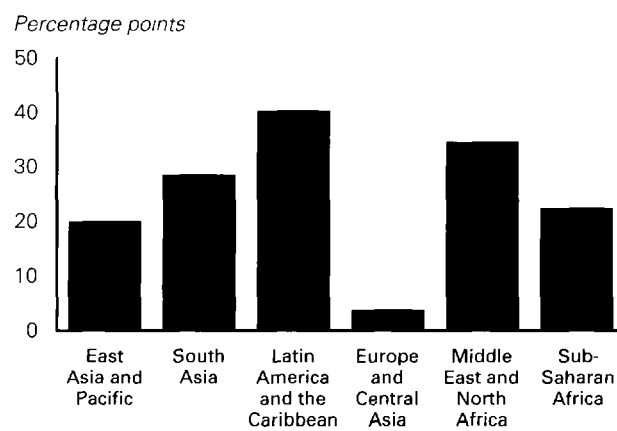
Table 11 Manufactures unit value, LIBOR, and commodity prices, selected years, 1965–95

		1965	1970	1972	1973	1974	1975	1976	1977	1978	1979	1980
G-5 unit value index of manufactures[a]		22	25	29	33	41	45	46	50	58	66	72
LIBOR[b]		5.0	8.9	6.0	9 4	10.8	7.7	6.1	6.4	9.2	12.2	14.0

Commodity price indexes[c]	Weights (percent)											
Petroleum		6	5	8	12	48	46	51	55	57	135	161
Nonfuel commodities		41	44	45	68	92	75	88	109	102	117	126
Agriculture	69.1	42	46	48	76	100	81	99	128	117	130	139
Food	29.4	43	47	52	92	137	101	86	90	99	113	139
Beverages	16.9	48	59	57	75	88	83	158	271	203	211	185
Raw materials	22.8	37	36	36	57	63	54	71	71	76	93	104
Metals and minerals	28.1	37	41	36	50	61	53	61	66	68	85	95
Fertilizers	2.7	39	30	43	60	195	158	76	75	73	100	129

Commodity prices[d]	Units											
Agriculture												
Cocoa	cents/kg	37	67	64	113	156	125	204	379	340	329	260
Coffee	cents/kg	100	115	110	137	145	144	315	517	359	382	347
Tea	cents/kg	129	110	105	106	140	139	154	269	219	216	223
Sugar	cents/kg	5	8	16	21	66	45	26	18	17	21	63
Banana	$/mt	159	165	161	165	184	247	257	275	287	326	379
Wheat	$/mt	59	55	70	140	180	149	133	103	128	160	173
Rice	$/mt	119	126	129	293	517	341	235	252	346	313	411
Maize	$/mt	55	58	56	98	132	120	112	95	101	116	125
Coconut oil	$/mt	348	397	234	513	998	394	418	578	683	985	674
Palm oil	$/mt	273	260	217	378	669	434	407	530	600	654	584
Soybeans	$/mt	117	117	140	290	277	220	231	280	268	298	296
Soybean oil	$/mt	270	286	241	436	832	563	438	580	607	662	598
Cotton	cents/kg	63	63	79	136	142	116	169	155	157	169	205
Rubber	cents/kg	50	41	33	68	75	56	77	81	99	126	142
Other												
Logs	$/cm	35	43	41	68	82	68	92	93	97	170	196
Sawnwood	$/cm	157	175	171	224	247	223	264	265	272	366	396
Urea	$/mt		48	59	95	316	198	112	127	145	173	222
Metals and minerals												
Copper	$/mt	1,290	1,413	1,071	1,786	2,059	1,237	1,401	1,310	1,367	1,985	2,182
Aluminum	$/mt	474	556	511	589	674	797	896	1,050	1,088	1,230	1,456
Nickel	$/mt	1,735	2,846	3,080	3,373	3,825	4,570	4,974	5,203	4,610	5,986	6,519
Gold	($/toz)	35	36	58	97	159	161	125	148	193	307	608
Phosphate rock	$/mt	13	11	12	14	55	67	36	31	29	33	47
Steel products index (1990 =100)		25	31	30	46	66	52	54	53	68	76	79
Energy												
Crude petroleum	$/bbl	1.4	1.2	1.8	2 8	11.0	10.4	11.6	12.6	12.9	31.0	36.9
Coal	$/mt	.	..	.	..	.	..	..	33.4	39.6	35.4	43.1

a. Unit value index in U S dollar terms (1990=100) of manufactures exported from the G-5 countries (France, Germany, Japan, United Kingdom, and United States), weighted by the country's exports to developing countries
b. London interbank offered rate on six-month U.S dollar deposits.

Price indexes relative to manufactures unit value index, 1985–95

Index (1990=100)

86
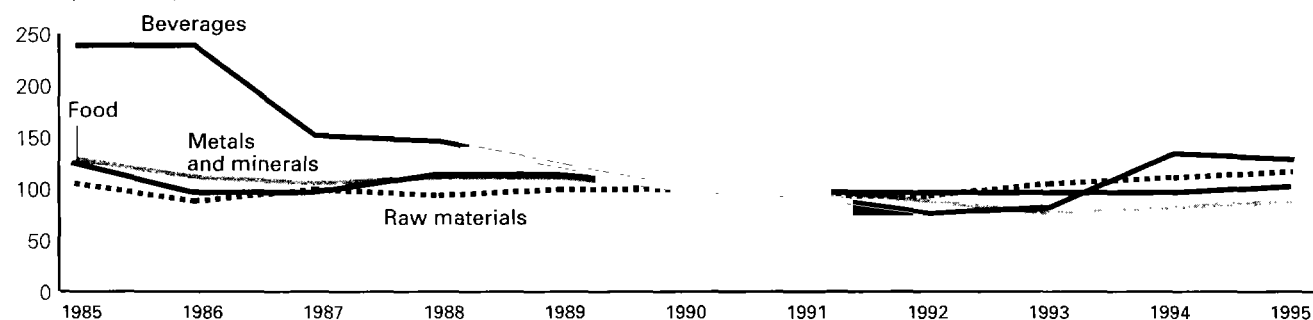
1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
72	71	70	68	69	81	89	95	95	100	102	107	106	110	115
16 7	13.6	9.9	11.3	8.6	6.8	7.3	8.1	9.3	8 4	6.1	3.9	3.4	5.1	6.1

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
155	143	130	125	119	63	79	64	78	100	85	83	74	69	75
109	96	103	105	92	93	93	111	108	100	95	92	92	112	122
118	104	112	118	101	104	99	110	106	100	98	94	99	124	132
123	97	105	107	86	77	84	107	108	100	99	100	99	107	117
149	150	157	180	165	196	136	141	115	100	94	79	85	150	152
90	80	88	87	71	70	90	91	97	100	99	98	110	126	135
83	75	82	74	70	65	78	114	111	100	89	86	74	85	102
122	105	98	98	89	89	94	109	106	100	102	96	84	93	104

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
208	174	212	240	225	207	199	158	124	127	120	110	112	140	143
287	309	291	319	323	429	251	303	239	197	187	141	156	331	333
202	193	233	346	198	193	171	179	202	203	184	200	186	183	164
37	19	19	11	9	13	15	22	28	28	20	20	22	27	29
401	374	429	370	380	382	393	478	547	541	560	473	443	439	445
175	160	157	152	136	115	113	145	169	136	129	151	140	150	177
459	272	257	232	197	186	215	277	299	271	293	268	235	268	321
131	109	136	136	112	88	76	107	112	109	107	104	102	108	123
570	464	730	1,155	590	297	442	565	517	337	433	578	450	608	670
571	445	501	729	501	257	343	437	350	290	339	394	378	528	628
288	245	282	282	224	208	216	304	275	247	240	236	255	252	259
507	447	527	724	572	342	334	463	432	447	454	429	480	616	625
185	160	185	179	132	106	165	140	167	182	168	128	128	176	213
112	86	106	96	76	81	98	118	97	86	83	86	83	113	158

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
155	146	138	157	122	139	202	201	191	177	191	210	390	308	256
349	339	328	352	307	329	401	402	485	533	553	607	758	821	740
216	159	135	171	136	107	117	155	132	157	172	140	107	148	212

1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
1,742	1,480	1,592	1,377	1,417	1,374	1,783	2,602	2,848	2,662	2,339	2,281	1,913	2,307	2,936
1,263	992	1,439	1,251	1,041	1,150	1,565	2,551	1,951	1,639	1,302	1,254	1,139	1,477	1,806
5,953	4,838	4,673	4,752	4,899	3,881	4,872	13,778	13,308	8,864	8,156	7,001	5,293	6,340	8,228
460	376	423	360	318	368	446	437	381	383	362	344	360	384	384
50	42	37	38	34	34	31	36	41	41	43	42	33	33	35
82	71	67	70	61	62	72	94	106	100	99	88	91	93	107

| 1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
35 5	32.7	29.7	28.6	27.2	14.4	18.2	14.7	17.8	22.9	19 4	19.0	16.8	15.9	17.2
56.5	52.2	44.5	48.6	46.6	43.9	36.2	37.1	40.5	41.7	41.5	40.6	38.0	36.5	39.2

c Indexes are in current U S. dollar terms (1990=100)
d. World Bank commodity prices were revised in April 1995 Price series for wheat, rice, rubber, sawnwood and crude petroleum are not comparable to those in previous editions
Source: World Bank data.

Price indexes relative to manufactures unit value index, 1985–95

Index (1990=100)
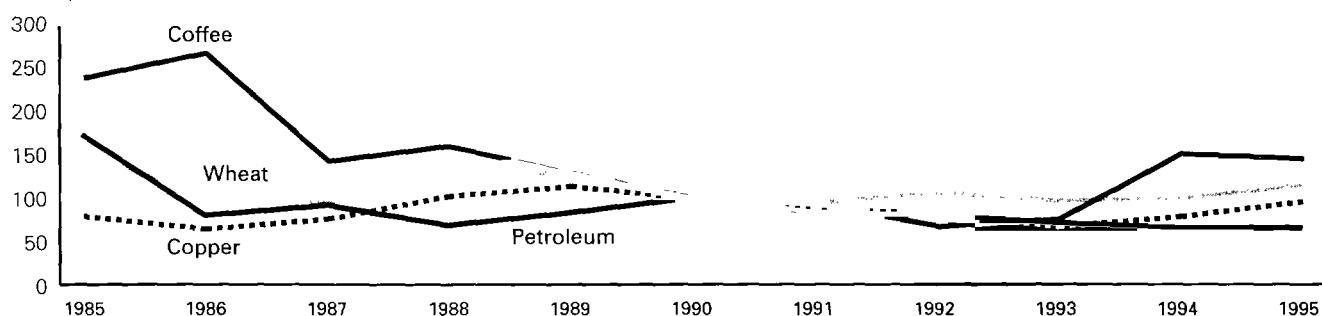
Technical notes

The principal sources for the data contained in this statistical annex are the World Bank's central databases.

Regional aggregates are based on the classification of economies by income group and region, following the Bank's standard definitions (see country classification tables that follow). Debt and finance data refer to the 136 countries that report to the Bank's Debtor Reporting System (see *World Debt Tables 1996*). Small economies have generally been omitted from the tables but are included in the regional totals.

Current price data are reported in U.S. dollars.

Notes on tables

Tables 1 through 4. Projections are consistent with those highlighted in chapter 1 and appendix 1.
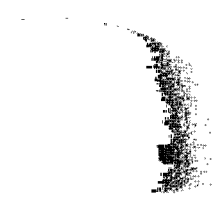
Tables 5 and 6. Merchandise exports and imports exclude trade in services. Imports are reported on a c.i.f. basis. Growth rates are based on constant price data, which are derived from current values deflated by relevant price indexes. Effective market growth is the export-weighted import growth rate of the country's trading partners. The UNCTAD trade database is the principal source for data through 1993; data for 1994 are from IMF and UN COMTRADE databases or World Bank staff estimates.

Tables 7 and 8. Growth rates are compound averages and are computed for current dollar measures of trade.

Table 9. Long-term debt covers public and publicly guaranteed external debt but excludes IMF credits. Concessional debt is debt with an original grant element of 25 percent or more. Nonconcessional variable interest rate debt includes all public and publicly guaranteed long-term debt with an original grant element of less than 25 percent whose terms depend on movements of a key market rate. This item conveys information about the borrower's exposure to changes in international interest rates. For complete definitions, see *World Debt Tables 1996*.

Table 10. Long-term net resource flows are the sum of net resource flows on long-term debt (excluding IMF) plus non–debt creating flows. Foreign direct investment refers to the net inflows of investment from abroad. Portfolio equity flows are the sum of country funds, depository receipts, and direct purchases of shares by foreign investors. For complete definitions, see *World Debt Tables 1996*.

Table 11. Commodity price data are collected by the International Economics Department of the World Bank. World Bank commodity price series for wheat, rice, rubber, sawnwood, and crude petroleum were revised in April 1995. As a result, commodity price indexes are not strictly comparable to previous editions of *Global Economic Prospects*.

Classification of Economies

Table 1 Classification of economies by income and region, 1996

Income group	Subgroup	Sub-Saharan Africa		Asia		Europe and Central Asia		Middle East and North Africa		
		East and Southern Africa	West Africa	East Asia and Pacific	South Asia	Eastern Europe and Central Asia	Rest of Europe	Middle East	North Africa	Americas
Low-income		Burundi Comoros Eritrea Ethiopia Kenya Lesotho Madagascar Malawi Mozambique Rwanda Somalia Sudan Tanzania Uganda Zaire Zambia Zimbabwe	Benin Burkina Faso Cameroon Central African Republic Chad Congo Côte d'Ivoire Equatorial Guinea Gambia, The Ghana Guinea Guinea-Bissau Liberia Mali Mauritania Niger Nigeria São Tomé and Principe Senegal Sierra Leone Togo	Cambodia China Lao PDR Mongolia Myanmar Vietnam	Afghanistan Bangladesh Bhutan India Nepal Pakistan Sri Lanka	Albania Armenia Azerbaijan Bosnia and Herzegovina Georgia Kyrgyz Republic Tajikistan		Yemen, Rep.	Egypt, Arab Rep.	Guyana Haiti Honduras Nicaragua
Middle-income	Lower	Angola Botswana Djibouti Namibia Swaziland	Cape Verde	Fiji Indonesia Kiribati Korea, Dem. Rep. Marshall Islands Micronesia, Fed Sts N Mariana Islands Papua New Guinea Philippines Solomon Islands Thailand Tonga Vanuatu Western Samoa	Maldives	Belarus Bulgaria Croatia Estonia Kazakstan Latvia Lithuania Macedonia, FYR[a] Moldova Poland Romania Russian Federation Slovak Republic Turkmenistan Ukraine Uzbekistan Yugoslavia, Fed. Rep.	Turkey	Iran, Islamic Rep. Iraq Jordan Lebanon Syrian Arab Republic West Bank and Gaza	Algeria Morocco Tunisia	Belize Bolivia Colombia Costa Rica Cuba Dominica Dominican Republic Ecuador El Salvador Grenada Guatemala Jamaica Panama Paraguay Peru St. Vincent and the Grenadines Suriname Venezuela
	Upper	Mauritius Mayotte Reunion Seychelles South Africa	Gabon	American Samoa Guam Korea, Rep. Malaysia New Caledonia		Czech Republic Hungary Slovenia	Greece Isle of Man Malta	Bahrain Oman Saudi Arabia	Libya	Antigua and Barbuda Argentina Barbados Brazil Chile French Guiana Guadeloupe Martinique Mexico Puerto Rico St. Kitts and Nevis St. Lucia Trinidad and Tobago Uruguay
Subtotal: 165		27	23	25	8	27	4	10	5	36

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Table 1 *(continued)*

Income group	Subgroup	Sub-Saharan Africa - East and Southern Africa	West Africa	Asia - East Asia and Pacific	South Asia	Europe and Central Asia - Eastern Europe and Central Asia	Rest of Europe	Middle East and North Africa - Middle East	North Africa	Americas
High-income	OECD Countries			Australia Japan New Zealand			Austria Belgium Denmark Finland France Germany Iceland Ireland Italy Luxembourg Netherlands Norway Portugal Spain Sweden Switzerland United Kingdom			Canada United States
	NonOECD Countries			Brunei French Polynesia Hong Kong Macao Singapore OAE[b]			Andorra Channel Islands Cyprus Faeroe Islands Greenland Liechtenstein Monaco	Israel Kuwait Qatar United Arab Emirates		Aruba Bahamas, The Bermuda Cayman Islands Netherlands Antilles Virgin Islands (US)
Total:	210	27	23	34	8	27	28	14	5	44

a. Former Yugoslav Republic of Macedonia.
b. Other Asian economies—Taiwan, China.

For operational and analytical purposes, the World Bank's main criterion for classifying economies is gross national product (GNP) per capita. Every economy is classified as low-income, middle-income (subdivided into lower-middle and upper-middle), or high-income. Other analytical groups, based on geographic regions, exports, and levels of external debt, are also used.

Low-income and middle-income economies are sometimes referred to as developing economies. The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing similar development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status.

Definitions of groups

These tables classify all World Bank member countries, and all other economies with populations of more than 30,000.

Income group: Economies are divided according to 1994 GNP per capita, calculated using the *World Bank Atlas* method. The groups are: low-income, $725 or less; lower-middle-income, $726–$2,895; upper-middle-income, $2,896–$8,955; and high-income, $8,956 or more.

The estimates for the republics of the former Soviet Union are preliminary and their classification will be kept under review.

Table 2 Classification of economies by major export category and indebtedness, 1996

| | Low- and middle-income | | | | | | | High-income | |
| | Low-income | | | Middle-income | | | | | |
Group	Severely indebted	Moderately indebted	Less indebted	Severely indebted	Moderately indebted	Less indebted	Not classified by indebtedness	OECD	nonOECD
Exporters of manufactures		India Pakistan	Armenia China Georgia Kyrgyz Republic	Bulgaria	Russian Federation	Belarus Czech Republic Estonia Korea, Dem. Rep. Korea, Rep Latvia Lebanon Lithuania Malaysia Moldova Romania Thailand Ukraine Uzbekistan		Canada Finland Germany Ireland Italy Japan Sweden Switzerland	Hong Kong Israel Macao Singapore OAE*
Exporters of nonfuel primary products	Burundi Côte d'Ivoire Equatorial Guinea Ghana Guinea Guinea-Bissau Guyana Honduras Liberia Madagascar Mali Mauritania Myanmar Nicaragua Niger Rwanda São Tomé and Principe Somalia Sudan Tanzania Togo Uganda Vietnam Zaire Zambia	Albania Chad Malawi Zimbabwe	Mongolia	Bolivia Cuba Peru	Chile	Botswana Namibia Solomon Islands Suriname Swaziland	American Samoa French Guiana Guadeloupe Reunion	Iceland New Zealand	Faeroe Islands Greenland
Exporters of fuels (mainly oil)	Congo Nigeria			Algeria Angola Gabon Iraq	Venezuela	Bahrain Iran, Islamic Republic Libya Oman Saudi Arabia Trinidad and Tobago Turkmenistan			Brunei Qatar United Arab Emirates
Exporters of services	Cambodia Ethiopia Mozambique Yemen, Rep.	Benin Comoros Egypt, Arab Rep. Gambia, The Haiti Nepal	Bhutan Burkina Faso Lesotho	Jamaica Jordan Panama	Cape Verde Dominican Republic Greece Morocco Western Samoa	Antigua and Barbuda Barbados Belize Djibouti El Salvador Fiji Grenada Kiribati Maldives Paraguay Seychelles St. Kitts and Nevis St. Lucia Tonga Vanuatu	Martinique	United Kingdom	Aruba Bahamas, The Bermuda Cayman Islands Cyprus French Polynesia Kuwait Monaco

Table 2 *(continued)*

Group	Low-income Severely indebted	Low-income Moderately indebted	Low-income Less indebted	Middle-income Severely indebted	Middle-income Moderately indebted	Middle-income Less indebted	Not classified by indebtedness	High-income OECD	High-income nonOECD
Diversified exporters[b]	Afghanistan Cameroon Central African Republic Kenya Sierra Leone	Bangladesh Lao PDR Senegal	Azerbaijan Sri Lanka Tajikistan	Argentina Brazil Ecuador Mexico Poland Syrian Arab Republic	Colombia Hungary Indonesia Papua New Guinea Philippines Tunisia Turkey Uruguay	Costa Rica Dominica Guatemala Kazakstan Malta Mauritius South Africa St. Vincent and the Grenadines Yugoslavia, Fed. Rep.		Australia Austria Belgium Denmark France Luxembourg Netherlands Norway Portugal Spain United States	Netherlands Antilles
Not classified by export category						Croatia Macedonia, FYR[c] New Caledonia Slovak Republic Slovenia	Bosnia and Herzegovina Eritrea Guam Isle of Man Marshall Islands Mayotte Micronesia, Fed. Sts. N. Mariana Islands Puerto Rico West Bank and Gaza		Andorra Channel Islands Liechtenstein Virgin Islands (US)
Number of economies 210	36	15	11	17	16	55	15	22	23

a. Other Asian economies—Taiwan, China.
b Economies in which no single export category accounts for 50 percent or more of total exports.
c. Former Yugoslav Republic of Macedonia.

Definitions of groups

These tables classify all world Bank member economies, plus all other economies with populations of more than 30,000.

Major export category: Major exports are those that account for 50 percent or more of total exports of goods and services from one category, in the period 1990–93. The categories are: nonfuel primary (SITC 0,1,2,4, plus 68); fuels (SITC 3); manufactures (SITC 5 to 9, less 68); and services (factor and nonfactor service receipts plus workers' remittances). If no single category accounts for 50 percent or more of total exports, the economy is classified as *diversified.*

Indebtedness: Standard World Bank definitions of severe and moderate indebtedness, averaged over three years (1992–94) are used to classify economies in this table. *Severely indebted* means

either of the two key ratios is above critical levels: present value of debt service to GNP (80 percent) and present value of debt service to exports (220 percent). *Moderately indebted* means either of the two key ratios exceeds 60 percent of, but does not reach, the critical levels. For economies that do not report detailed debt statistics to the World Bank Debtor Reporting System (DRS), present-value calculation is not possible. Instead, the following methodology is used to classify the non-DRS economies. *Severely indebted* means three of four key ratios (averaged over 1992–94) are above critical levels: debt to GNP (50 percent); debt to exports (275 percent); debt service to exports (30 percent); and interest to exports (20 percent). *Moderately indebted* means three of the four key ratios exceed 60 percent of, but do not reach, the critical levels. All other classified low- and middle-income economies are listed as *less-indebted.*

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Global Economic Prospects and the Developing Countries 1996 is the sixth in the annual series issued by the World Bank. This year's study focuses on the effects of globalization on developing countries and the growing divide between fast and slow-integrating economies.

The pace of global economic integration continues to accelerate dramatically. In the ten years from 1985 to 1994, the ratio of world trade to GDP rose three times faster than during the previous decade. During this same ten-year period, foreign direct investment (FDI) doubled as a share of global GDP. Developing countries as a group have participated extensively in the acceleration of global integration. Over the past decade their overall ratio of trade to GDP rose 1.2 percentage points a year, while the fraction of FDI going to developing countries rose to more than one-third.

A closer look, however, reveals sharp disparities between countries. Though developing countries in the aggregate kept pace with the world rate of trade integration, the ratio of trade to GDP actually *fell* in some 44 out of 93 developing countries in the last ten years. There were similar disparities in the distribution of FDI: two-thirds of total FDI went to just eight developing countries; half received little or none. This trend is likely to continue. Projections indicate that trade and investment will accelerate in those countries which open up to the global economy, and stay stagnant in those that do not.

At the same time, there has never been a better time for developing countries to integrate. Projected generally favorable conditions in the global economy, including stable energy prices, low interest rates and inflation, and improved communications and transportation technology, have created an environment conducive to market liberalization. Moreover, traditional obstacles to developing country integration, such as high tariff barriers, are falling rapidly. Tariff rates internationally are lower now than at any time since World War II.

Many developing countries in every part of the world have successfully pursued policies of greater openness to the global economy, and there is much to learn from their experience. The report documents the evidence, provides case study analyses, and makes recommendations about best-practice approaches to market liberalization, especially in the areas of trade and commodities.

For many developing countries, successful globalization depends on fundamental economic reform, requiring difficult policy decisions that often lead to real short-term dislocation. These costs must be acknowledged from the outset, and the effects carefully taken into account in the design of the programs. But the costs are manageable. In fact, openness to external trade and investment is often the necessary first step to solid, sustainable economic development. This year's *Global Economic Prospects and the Developing Countries* helps put this relationship in context and provides needed perspective on many important and controversial questions about the future of the world economy.