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Global Economic Prospects

and the Developing Countries

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Summary

TECHNOLOGICAL INNOVATIONS AND THE dismantling of trade barriers over the past decade have contributed to an acceleration of growth in global trade. This acceleration has been associated with faster growth in developing countries as a group. However, many of the poorest countries have not kept pace. This year's *Global Economic Prospects* focuses on international trade and discusses policies that are required if developing countries are to benefit from global integration.

Prospects for developing countries and world trade

The global economy is likely approaching a cyclical high in 2000, boosted by a further acceleration of growth in the United States, the recovery in Europe and Japan, and the sharp rebound in countries affected by the global financial crisis. World trade volumes are likely to increase by 12.5 percent, the highest rate of growth since before the first oil shock of the 1970s. A moderation of growth in the crisis countries and slower consumption growth in the United States are likely to lead to a deceleration of output growth over the next year.

The apparent shift upward in trend productivity growth in the United States, increased labor market flexibility and product market competition in Europe, and steps toward financial and corporate restructuring in Japan have improved the prospects for long-term growth. The same applies in developing countries, where liberalization of markets, more stable macroeconomic policies, and technological change have promoted integration. Indicators of human capital, including school enrollment and literacy rates, show broad improvement across most developing regions.

However, cyclical and structural aspects of the current boom have increased imbalances and tensions in the global economy. Easier monetary policy in the United States and increased fiscal stimulus in Japan boosted growth from the depths of the financial crisis, but these policies also increased the already large U.S. current account deficit (4.5 percent of GDP) and Japanese government debt (115 percent of GDP). The strong global recovery of 1999–2000, coupled with the sharp reduction in OPEC (Organization of Petroleum Exporting Countries) supply, caused a surge in oil prices. Structural reforms and rapid technological change have also generated political tensions. The fast pace of global economic integration has accentuated competition and increased uncertainty, particularly for firms in declining industries and their workers. Inequality both among and within countries appears to have risen, in part the result of technological progress.

A low-case scenario assumes a less favorable resolution of these imbalances and tensions, marked by continued high oil prices and a reversal of international investment flows from the United States. The resulting reces-

sion, coming on the heels of the global financial crisis, may feed "reform fatigue" and thus lower developing countries' long-term growth potential.

Trade policies in the 1990s and the poorest countries

Over the past decade, developing countries reduced the level and dispersion of tariffs, dismantled nontariff trade barriers, and increased reliance on market forces to allocate foreign exchange. These policies, coupled with other market reforms, were associated with an acceleration of output and export growth, except for countries that were affected by conflict or the breakup of the Soviet Union. The per capita income of small, low-income countries (thus excluding China and India) declined during the 1990s, but growth averaged 1 percent a year if countries involved in conflict and countries in transition are excluded. This represents a significant acceleration compared with the 1980s but is still well below the average of middle-income countries.

Weaknesses in trade-related policies continued to impede growth in many of the poorest countries. Appreciated real exchange rates and high real exchange rate volatility have often been associated with a muted export response to trade liberalization; per capita income growth was significantly faster in poor countries with relatively stable real exchange rates. The absence of effective duty exemption/drawback programs, coupled with fiscal reliance on tariffs on intermediate and capital goods, has increased costs for exporters. Finally, weak export infrastructure, inadequate ancillary export services, and high transport costs—often in part the result of policy shortcomings—have left many countries (particularly the landlocked ones) at a competitive disadvantage on international markets.

High trade barriers imposed by industrial countries on agriculture and processed food imports, along with agricultural subsidies, have contributed to the decline in developing countries' share of world trade in these commodities. These trade distortions have particularly affected the poorest countries, because a host of other domestic policy and institutional weaknesses inhibit their diversification into less restricted sectors.

Standards, developing countries, and the global trading system

Product standards (rules governing the characteristics of goods that are generally imposed to protect health and safety) are critical to the effective functioning of markets and provide important support to the trade system. However, many developing countries (particularly the poorest ones) lack the technological and financial resources to develop product standards effectively, meet industrial countries' import requirements, and bring disputes when standards are used to discriminate against their exports.

Adherence to labor and environmental standards (for example, the right to form unions and limits on pollution) is critical to economic efficiency and welfare. However, pressures to use trade sanctions to support labor and environmental standards threaten to restrict developing countries' access to international markets while doing little to improve welfare. Labor and environmental standards generally improve as countries develop, but low labor and environmental standards are not usually a significant source of competitive advantage. The imposition of trade sanctions is vulnerable to capture by protectionist interests and hurts workers by reducing demand for the goods they produce. Even if the threat of sanctions improves conditions for some workers, average working conditions in the economy are unlikely to improve. Similarly, empirical studies show that imposing trade sanctions on exporters can cause considerable output losses while doing little to reduce pollution.

Electronic commerce and the developing countries

The Internet will boost efficiency and enhance market integration, particularly in developing countries that are most disadvan-

taged by poor access to information. The Internet will raise productivity through increased procurement system efficiency, strengthened inventory control, lowered retail transaction costs, and elimination or transformation of intermediaries. The cost of reaching industrial country markets will fall, generating large gains from trade. Developing-country firms that sell labor-intensive, differentiated products (for example, crafts, software, and business services—particularly services involving the remote processing of routine information) will experience increased demand. Developing-country firms also will benefit from the opportunity to leapfrog to the most advanced technologies.

Nevertheless, Internet access is grossly unequal across countries, and the Internet also brings increased danger of economic marginalization to countries that cannot access it effectively. For example, developing-country firms that lack the reputation to bid on the new online exchanges or the technology to interact efficiently with more sophisticated firms could see reduced demand. While the growing use of cell phones and other technologies should increase Internet access rapidly over the next 10 years, access is likely to remain limited in per capita terms, especially in the poorest countries.

Taking advantage of electronic commerce requires an open economy to promote competition and diffusion of Internet technologies; improved international coordination (for example, in confronting challenges to domestic tax and financial systems); and efficient social and infrastructure services, in particular a competitive telecommunications sector and a well-educated labor force. The importance of network effects and first-mover advantages emphasizes the importance of government support for achieving these goals.

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Abbreviations, Acronyms, and Data Notes

APEC	Asia Pacific Economic Cooperation
CAP	Common Agricultural Policy
CEE	Central and Eastern Europe (Central and Eastern European countries are CEECs)
CFA	Communauté Financière Africaine
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
EMU	European Monetary Union
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GSP	Generalized System of Preferences
HIPC	Heavily Indebted Poor Countries
HIV/AIDS	human immunodeficiency virus/acquired immune deficiency syndrome
ILO	International Labour Organisation
IT	Information technology
LAC	Latin America and the Caribbean
LIBOR	London interbank offered rate.
LDC	Least-developed countries
M&A	Mergers and acquisitions
MNA	Middle East and North Africa (use MNA instead of MENA)
Mercosur	Latin American Southern Cone trade bloc (Argentina, Brazil, Paraguay, and Uruguay)
MFN	Most favored nation

MFP	Multifactor productivity
MRA	Mutual recognition agreement
MUV	Manufactures unit value index
NAFTA	North American Free Trade Agreement
NASDAQ	National Association of Securities Dealers Automated Quotation
NIE	Newly industrializing economies
NTBs	Nontariff barriers
OECD	Organisation for Economic Development and Co-operation
OPEC	Organization of Petroleum Exporting Countries
PSE	Producer support estimate
RIA	Regional integration agreement
saar	Seasonally adjusted annualized rate
TBT	Technical Barriers to Trade
TRIPs	Trade-related intellectual property requirements
SPS	Sanitary and Phytosanitary Standards
UNAIDS	Joint United Nations Programme on HIV/AIDS
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 volume 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 1998 are actual, data for 1999 are estimated, and data for 2000 onward are projected.