Part One
SOCIAL CONDITIONS

1. In the 1990s we have witnessed an increasing awareness of the intimate linkages between economic and social development. As the Copenhagen Declaration on Social Development put it:

> We are deeply convinced that economic development, social development and environmental protection are interdependent and mutually reinforcing components of sustainable development, which is the framework for our efforts to achieve a higher quality of life for all people.[1]

2. Sustained, broad-based economic growth is clearly instrumental for achieving equitable social development and universal well-being. Sound economic policies promoting economic growth, combined with equitable redistributive mechanisms, can ensure a more balanced distribution of income in society. Economic policies should provide a strong financial basis for addressing social issues, such as the alleviation of poverty, social integration, improved health and education, and the provision of productive employment.

3. Social policies in health, education and employment deserve major consideration in establishing priorities for national budgets, particularly in view of growing pressures from other social needs. In many countries government expenditures on social services have been subject to fiscal constraints imposed by shrinking budgets and shifts in public goals.

NOTE

[1] *Report of the World Summit for Social Development, Copenhagen, 6-12 March 1995* (United Nations publication, Sales No. E.96.IV.8), chap. I, resolution 1, para. 6.

Chapter I
ECONOMIC TRENDS

1. The world economy has grown moderately since 1994, at an average annual rate of 2.5 per cent in 1994-1996. The current growth rate is still below the average rate of the 1980s, because of the weakness of the economic recovery in developed economies (see table 1.1). Nevertheless, it represents a significant improvement over the poor economic growth in 1990-1993. Those years were marked by economic stagnation in developed economies and precipitous economic decline in transition economies. There was severe economic and social deterioration in many developing economies, though some maintained a steady rate of economic growth.

A. Regional economic performance

2. The current pattern of economic strengthening reflects a broad-based expansion among countries, most notably among transition and developing economies. The effects of earlier stabilization measures and ongoing efforts in structural adjustment in many of these countries reduced barriers to trade and improved the competitiveness of their exports. As a result, they were better able to expand their exports when international demand strengthened after 1993. Also, strong financial inflows since the early 1990s strongly supplemented domestic resources.

3. Against the backdrop of protracted economic decline in the 1980s, resulting in high unemployment and increased poverty in many developing countries, this recent improvement in economic performance must be interpreted with caution. Of the transition economies, only Poland has regained even the level of income that it had at the beginning of the transition. Many developing countries remain severely indebted, and current per capita income levels remain below those of 1980 in much of Africa, Latin America and West Asia. Although it is possible that the stronger economic growth seen in the past three years represents a turning point for the world economy, recent improvements will be sustained only with appropriate national policies and international developments.

1. *Developed economies*

4. The current economic recovery in the developed economies has been characterized by still modest economic growth, virtual stagnation of real wages and high levels of unemployment. At the same time, inflation has been reduced significantly and budget deficits are declining in a number of countries. Structural problems persist, especially in labour markets and in social security systems. Currently, only the United Kingdom and the United States have a lower level of unemployment than they averaged in the 1980s. The unemployment rate in the European Union (EU) hovers around the peak 1994 level of 11.2 per cent. Although economic growth is expected to strengthen in the near term, the extent of the recovery is constrained by a tight macroeconomic policy stance, which is intended to lay the foundation for stronger growth in the longer term. In many countries, Governments are finding it difficult to meet their previous commitments to provide social benefits, particularly because of demographic factors, and are consequently reviewing and revising their social programmes.

2. *Transition economies*

5. The change from centrally planned to market economies, which began in many of the transition economies in 1989, has led to sharp declines in output. Positive growth resumed in Poland in 1992. Subsequently, economic growth was positive in an increasing number of Central and Eastern European transition economies (CEETEs) and the Baltic States. Despite recent improvements, output in all but one CEETE has remained below levels of the late 1980s. Continued economic recovery in the CEETEs is expected, based on the strength of investment and exports. Many members of the Commonwealth of Independent States (CIS), which began their transition later, have not yet emerged from economic decline, although the reported rate of output decline has slowed, and growth in some CIS countries is now positive.

6. Domestic and foreign investment have responded to declining budget deficits and inflation, economic restructuring and rising demand. By deepening links with developed economies, in particular those of the EU, and undertaking economic restructuring, these economies have shown strong export growth. Revival of intraregional trade (discussed later) has also contributed to increased demand. High unemployment persists in most countries and is expected to decline in time only with continued structural adjustment and economic growth.

7. During the past years of economic decline and often high inflation, many of the transition economies have had to face the daunting task of constructing social safety nets, for example providing unemployment and pension benefits and health care services to replace the mainly government-directed and enterprise-based system that prevailed under central planning.

3. *Developing economies*

8. Economic growth in the developing economies began to strengthen at the beginning of the 1990s (see table 1.1). Since 1993, growth has spread to an increasing number of countries, with per capita GDP rising not only in the rapidly growing economies of South and East Asia and China, and the middle-income economies of Latin America, but also to lower-income developing economies, many of which are least developed countries in Africa. From a sample of 91 developing economies, per capita GDP in 75 is estimated to have increased in 1996, whereas per capita GDP rose in only 50 countries in 1993. Of those 75, 22 are least developed countries. The magnitude of per capita output growth has been small, however, remaining under 2 per cent in many cases. This modest

TABLE 1.1. GROWTH OF WORLD OUTPUT, 1981-1996
(Annual percentage change)

Area, country, or region	*1981-1990*	*1991*	*1992*	*1993*	*1994*	*1995*[a]	*1996*[b]
World[c]	2.9	0.3	1.1	0.9	2.4	2.4	2 ½
Developed economies	2.9	0.7	1.6	0.7	2.7	2.0	2
Economies in transition[d]	2.0	-8.6	-12.0	-6.9	-8.9	-1.8	2
Developing economies of which	3.1	3.5	4.9	5.0	5.5	5.2	5 ½
Latin American and the Caribbean	1.2	2.9	2.2	3.0	4.6	0.9	2 ½
Africa	2.0	1.3	0.9	0.4	2.5	2.7	4
West Asia	-1.3	-0.2	5.7	2.6	0.6	3.1	3
South & East Asia of which	6.0	5.4	5.2	5.5	6.7	7.1	6 ¾
South Asia[e]	5.3	2.7	3.9	3.9	5.2	5.9	6
China	9.0	8.0	13.2	13.4	11.8	10.2	9
Memorandum item:							
Number of countries with rising per capita output[f]	74	69	73	62	93	103	109

Source : UN/DESIPA.

a Preliminary estimate.
b Forecast, based in part on Project LINK.
c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP 1988 prices and exchange rates. An alternative weighting system for aggregation uses country weights derived from GDP in "international dollars", as converted from local currency using purchasing power parties as exchange rates. Based on this system the average annual GDP growth rate for the world is 3.2 per cent for 1981-1990 and 3 per cent for 1995 (see World Economic and Social Survey 1996, pp. 300-301 and table A.1).
d Based on reported GDP, which seriously underestimates activity in several countries.
e Bangladesh, India, Nepal, Pakistan and Sri Lanka.
f The number of countries in the sample is 1981-1990 and 1991:122; 1992:136; 1993-1996:137.

improvement after an extended period of very poor economic performance has not been sufficient to lift average per capita GDP in 1996 above 1980 levels in Africa and Latin America (see figure 1.1).

9. Domestic stabilization and structural adjustment policies, as well as the international economic environment, have been the prime determinants of growth in developing countries in the 1990s. The economic recovery generated by successful stabilization and economic reform programmes in major Latin American countries paused after the 1994-1995 Mexican financial crisis. The crisis revealed the vulnerability of the financial systems of several Latin American countries and forced new adjustment measures. The still-high levels of unemployment and poverty were aggravated by the economic reversal. But, the substantial reduction in inflation achieved in the early 1990s has largely been maintained, and economic growth in the region is clearly advancing beyond its 1995 level bolstered by substantial financial inflows, robust exports and stronger domestic demand.

10. Several African economies finally showed signs of emerging from the economic decline of the past 15 years, boasting economic improvement in 1995 and a further strengthening of growth in an increasing number of countries in 1996. Substantially higher demand, as well as higher international prices of non-oil commodities, have catalysed economic growth in commodity-exporting countries. Increased competitiveness in some countries resulting from progress in stabilization, structural adjustment and currency devaluation, such as in the CFA franc zone, have also boosted exports. The end of drought and the mitigation of violent conflict in some countries have also contributed to growth.

11. The prospects for continued strengthening of growth in Africa are, however, uncertain. There are serious structural constraints to long-term growth in sub-Saharan Africa. The undiversified output structure, heavily weighted towards commodities, leaves the economies in that region highly vulnerable to the volatility of international commodities markets. Severely inadequate infrastructure deters private investment and undermines efforts to expand exports. Low investment in physical and human resources and a high level of external indebtedness make it even more difficult to lessen these constraints.

12. Economic trends in West Asia have resulted largely from developments in the international oil market, progress towards peace in the region, budget consolidation and structural reform. Several oil-exporting countries recently began a process of fiscal consolidation in response to budget deficits exacerbated by the costs of the Gulf war and unfavourable oil prices. This action has constrained growth in the region, despite the recent rise in oil prices. Reductions in government expenditures can be expected to streamline the public enterprise sector and restrict the scope of social benefits previously financed by Governments. Unemployment has become more serious and extensive, having spread to even those countries that have employed large numbers of foreign workers.

13. The progress of the Middle East peace process in the 1990s has improved the environment for private investment in oil-importing countries, particularly Israel, Jordan and Lebanon. There has been a significant increase in domestic and foreign investment since 1994 in production and infrastructure, and economic growth in these countries rose as a result.

14. Economic growth in South and East Asia accelerated significantly after 1993, to around 7 per cent, from already substantial levels at the beginning of the 1990s (see table 1.1). Many of the rapidly growing countries benefited from strong domestic and foreign investment, including high levels of infrastructure investment. In addition, robust export growth in the region, averaging about 14 per cent annually, was spurred by the sharp appreciation of the yen, strong growth in intraregional trade and recovery of import demand in developed economies. Strong financial inflows into many of these economies provided additional stimulus. By 1995, sustained high growth had begun to impose upward pressure on prices. In some countries, particularly Malaysia and Thailand, the external account deficit deteriorated to unsustainably high levels (9 per cent and 7.5 per cent) because of very strong import growth, primarily of capital goods needed for investment. In response, monetary policy was tightened. Thus far, this policy stance and slackening export growth have moderated economic growth.

15. In countries that have undergone successful macroeconomic stabilization and economic reform since the beginning of the decade, particularly India, the Philippines and Viet Nam, economic growth has accelerated substantially in the past few years. At the same time, some South Asian economies, Bangladesh, Pakistan and Sri Lanka, have met obstacles in reducing budget and current account deficits, which have been exacerbated by political conflict, labour unrest or continued sectarian violence. These deficits have, in turn, held down economic growth.

16. With a strong economic recovery in the early 1990s, China had peak growth in 1993, at about 13.5 per cent. But, accelerating inflation led the Government to implement tight monetary policies and administrative controls on investment. These policies have controlled inflation at around 10 per cent, while maintaining high growth (9-10 per cent). Strong domestic and foreign investment, large financial inflows and strong export growth were the main contributors to the strength of the Chinese economy over the past several years.

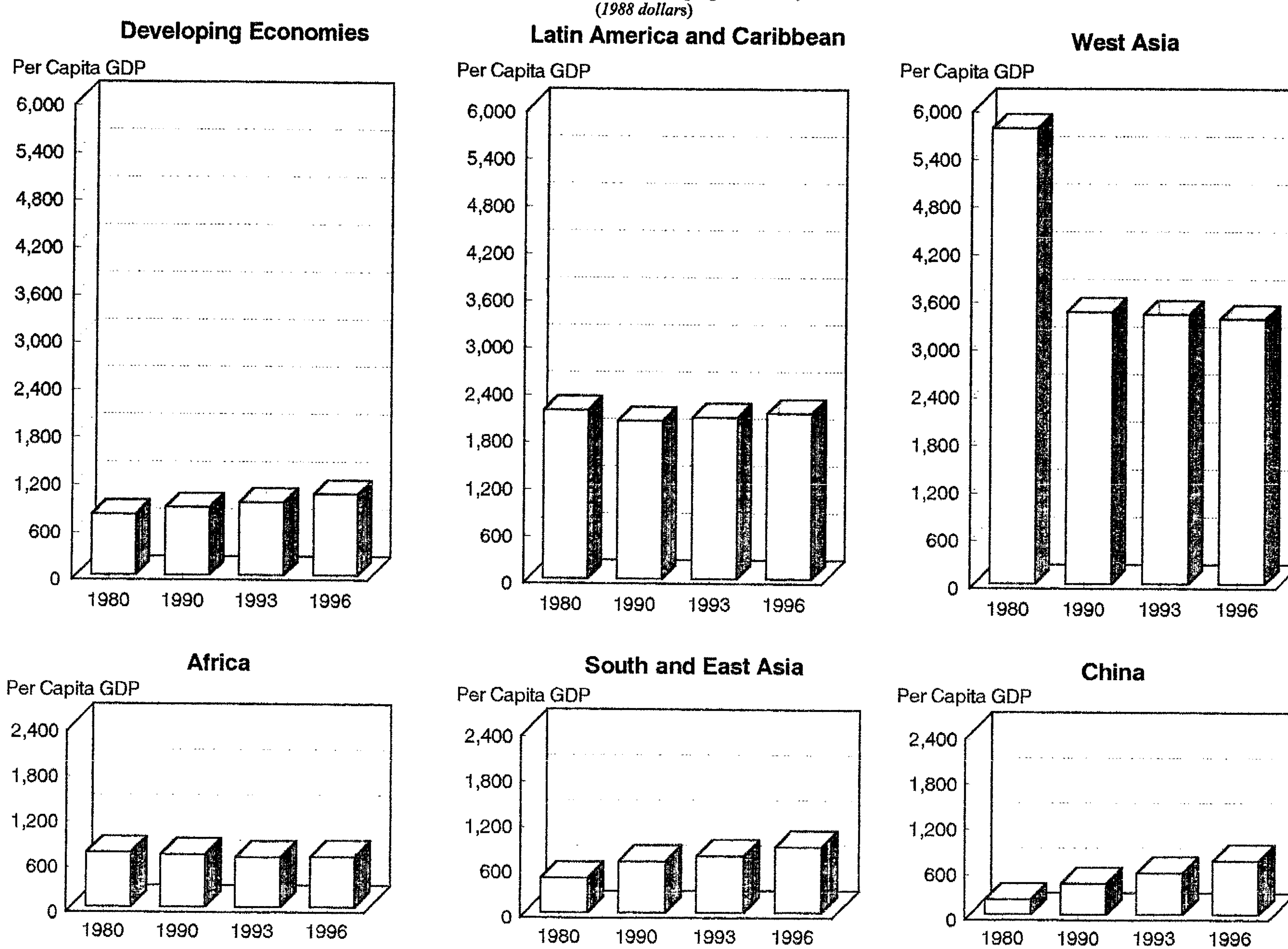
B. International economic environment

17. Domestic factors are primary determinants of national economic growth. With growing trade and financial liberalization in an increasing number of countries, dynamism and buoyancy in international trade and financial flows are also important to economic performance.

1. *World trade*

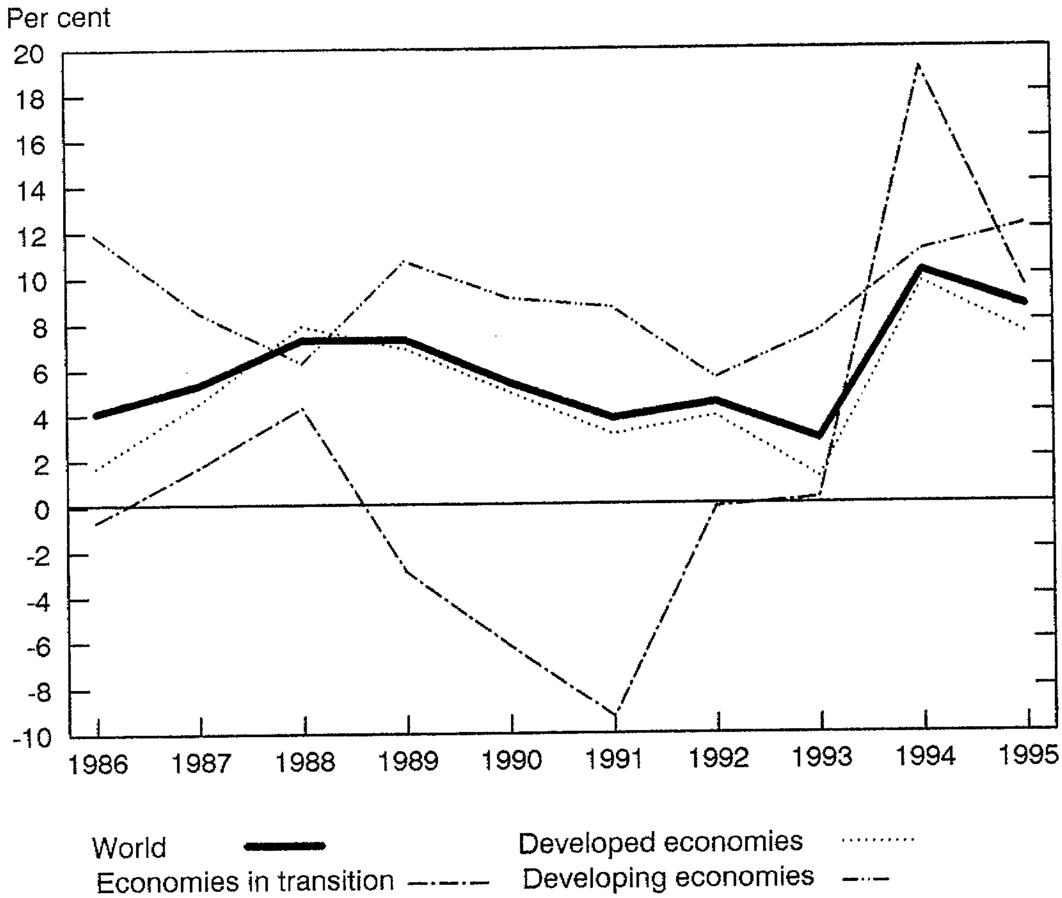
18. World trade has become much more dynamic in the past decade. The average annual increase in the volume of world trade soared from only 3.5 per cent in the first three years of this decade to 10 per cent in 1994, though moderated to under 9 per cent in 1995 (see figure 1.2). Growth has slowed further in 1996 to approximately 5.5 per cent. The rebound in 1994 was driven by strong import demand in the developed economies, generated by their economic recovery and exchange-rate realignments. As part of this trend international prices for oil and non-oil commodities rose substantially, improving export

Figure 1.1. Per capita GDP of developing economies, 1980-1996
(1988 dollars)



Source: UN/DESIPA.
Note: GDP is calculated on an exchange rate basis.

Figure 1.2. Growth of export volume, 1986-1995



Source: World Economic and Social Survey 1996, (New York, United Nations) table A.19.
Note: Economies in transition excludes former Soviet Union because of lack of data.

earnings of commodity exporters. Many economies in South and East Asia have expanded exports of more technologically advanced "information-age" goods, which have been less vulnerable to cyclical demand and thus able to sustain their rapid export growth in the 1990s.

19. Regional economic integration has also contributed to the growth in international trade. Trading within Asia has continued strongly, fostered by intraregional investment in response to changing production specializations among countries.[1] Regional trade is also expanding among a growing number of Latin American countries with trade liberalization and growing import demand. In Africa as well, growth in intraregional trade is becoming discernible, with more widespread trade liberalization and increased competitiveness resulting from currency devaluation, particularly in the CFA franc zone.

20. Although the CEETEs have increased trade with the developed economies since the beginning of the 1990s, there has been a revitalization of intraregional trade in the last two years, including trade among the CEETEs and between the CEETEs and the CIS countries. In 1995 the value of intra-CEETE trade increased by 25 per cent. Growth in intra-CIS trade has also been discernible since 1995, with a 40 per cent increase in exports from the Russian Federation to other CIS countries and a 70 per cent surge in imports from other CIS countries in the first quarter of 1996.[2]

2. *Access to international finance*

21. Access to external financial resources has been an important supplement to domestic savings in financing economic development in developing and transition economies in the 1990s. The balance on net external resource flows (net transfers) to the capital-importing developing economies has increased rapidly (see table 1.2).[3] After portfolio flows plunged in 1994 following the Mexican crisis, net private financial flows to countries in South and East Asia recovered, and they surged to South Africa. Inflows to Latin America have recovered more slowly but are now rebounding strongly. In addition, net private financial flows surged to the CEETEs. While lower international interest rates after 1995 have helped to resume international financial flows, improved eco-

TABLE 1.2. BALANCE ON EXTERNAL RESOURCE FLOWS OF CAPITAL-IMPORTING DEVELOPING COUNTRIES, 1985-1995
(Billions of dollars)

Source	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995* [a]
Flows through direct investment											
Net investment flows	8.3	6.1	9.3	15.4	17.4	16.8	22.7	30.9	46.8	58.7	63.6
Direct investment income: net	-8.7	-7.9	-8.9	-9.9	-11.5	-12.9	-12.6	-13.7	-16.2	-17.0	-17.8
Net resource flows	-0.4	-1.7	0.5	5.5	5.9	3.9	10.1	17.2	30.6	41.7	45.8
Flows through medium- and long-term foreign private borrowing											
Net credit flows	13.5	9.1	4.3	12.0	3.2	10.8	14.7	27.5	31.6	36.9	38.0
Interest paid	-38.9	-34.3	-33.5	-38.7	-32.6	-29.3	-28.1	-27.4	-24.8	-29.4	-42.3
Net resource flows	-25.5	-25.2	-29.2	-26.8	-29.4	-18.6	-13.5	0.1	6.8	7.5	-4.3
Flows through net stock transactions, short-term borrowing and domestic outflows [b]: net	-11.4	-6.8	-13.5	-22.3	-10.9	-2.5	21.7	24.6	36.8	1.6	29.3
Flows through private grants: net	-11.4	-6.8	-13.5	-22.3	-10.9	-2.5	21.7	24.6	36.8	1.6	29.3
Flows through official flows	3.7	4.7	5.0	6.2	4.8	6.3	7.9	9.5	9.0	7.9	8.0
Official transfers (grants)	10.8	10.3	11.7	12.3	13.3	17.6	17.7	15.8	12.7	10.4	10.4
Net official credits	19.0	18.5	16.0	13.5	20.1	22.2	20.6	16.3	17.4	10.4	35.9
Interest paid	-12.8	-15.7	-16.5	-17.9	-18.1	-20.6	-21.9	-22.1	-23.2	-24.5	-31.1
Net resource flows	17.0	13.1	11.2	7.9	15.4	19.2	16.4	10.0	7.0	-3.7	15.2
Total net resource flows (financial basis)	-16.5	-16.1	-26.0	-29.5	-14.3	8.2	42.6	61.4	90.2	55.0	94.0
Use of official reserves [c]	-0.8	12.0	-8.0	-2.9	-15.4	-36.4	-47.8	-47.2	-42.9	-19.4	-56.0
Total net resource flows (expenditure basis)	-17.3	-4.1	-34.0	-32.4	-29.7	-28.1	-5.2	14.2	47.3	35.6	38.0

Source: *World Economic and Social Survey, 1996* (New York, United Nations publication, Sales No. E.96.II.C.1), table A.27.

Note: The term "balance on external resource flows" is the same as "net transfer of financial resources". The sample consists of 93 countries, excluding the surplus-energy exporters (Brunei Darussalam, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Qatar, Saudi Arabia and the United Arab Emirates) and recent surplus countries (Hong Kong, Singapore and Taiwan Province of China). Direct investment is net of reinvested earnings (cash flow approach); official credits include use of IMF credit; interest includes IMF charges; private grants include net resource flow of gifts from overseas residents (excluding workers' remittances) and grants by non-governmental organizations.

a Preliminary estimate.

b Calculated as a residual {includes short-term trade financing, normal and unusual outflows ("capital flight"), arrears on interest due and other flows captured in balance-of-payments data as "errors and omissions" and presumed to be financial flowfls}.

c Additions to reserves are shown as negative numbers.

nomic performance and continued economic reform have also played an important part. These developments are positive indications of the sustainability of private financial transfers to these regions.

22. The vastly increased importance of private international finance in this decade has benefits and risks. While recipient countries can benefit economically from these resources, their numbers are small (around 20), and many low-income and highly indebted countries are being by-passed. Furthermore, the experience of Mexico has underscored the potential volatility of short-term private financial flows and the costly economic adjustment that this approach can entail if appropriate policies are not followed. This event has heightened awareness of the necessary policies that recipient countries must adopt to minimize the destabilizing effects of financial inflows. Thus, concrete efforts have been made through the International Monetary Fund (IMF) to encourage sound policy-making and to establish safeguards to contain the effects of another large-scale financial crisis. These include enhanced surveillance of economic conditions in member countries and an emergency financing mechanism for countries in financial crisis, supported by greatly expanded funding.[4]

23. Low-income countries by-passed by private finance continue to rely heavily on official flows for net financial transfers. At the same time, flows of official development assistance (ODA) have begun to shrink. Developed country donors have been re-examining the goals and efficacy of official financial cooperation. Domestic political support for ODA in several industrialized countries has eroded seriously, although the commitment to ODA remains strong in many others. The amount of ODA from the donor countries in the Development Assistance Committee of the Organisation for Economic Cooperation and Development (OECD) was $59 billion in 1995, continuing a trend of stagnation since 1992. In real terms (taking into account price and exchange rate changes) the volume of ODA declined by 13 per cent between 1992 and 1995.[5] Moreover, the capacity of traditional donors in West Asia and the transition economies to provide aid has been undermined by economic difficulties resulting from diminished oil revenues, the costs of war and the dislocations of transition.

24. Many developing countries are still faced with excessive debt-servicing burdens. While Latin American countries have regularized their relations with creditors, many other developing countries, mainly in Africa, are still burdened with debt that they are unlikely to service. Prospects for reducing significantly the debt burden of these developing countries have improved markedly with the September agreement among Paris Club creditor countries, the IMF and the World Bank on a new initiative for official bilateral and multilateral debt relief. This agreement focuses on providing greater debt relief for "highly indebted poor countries" (HIPCs), whose current level of debt has been assessed as unsustainable and an insurmountable obstacle to the revival of economic growth.[6]

25. Debt relief itself is one component of the development programme required by the heavily indebted countries. Clearing arrears and establishing a sustainable debt-servicing position create an opportunity which, combined with structural adjustment and official financial support, can promote foreign and private investment and, thus, economic growth.

NOTES

[1]For example, exports between selected developing countries in South and East Asia and China increased by 93 per cent between 1990 and 1994, whereas exports to the world grew by only 64 per cent. (See UNCTAD, *Trade and Development Report 1996* (United Nations publication, Sales No. E.96.II.D.6), pp. 86-92.

[2]Trade statistics for CEETEs and CIS countries are from *World Economic and Social Survey 1996* (United Nations publication, Sales No. E.96.II.C.1), pp. 61 and 62.

[3]The balance on net external resource flows (calculated on a financial basis) is defined as the sum of net financial inflows and investment income payments. Calculated on an expenditure basis, it includes changes in official reserve holdings. For the definition of this country grouping see note in table 1.2.

[4]See the report of the Secretary-General entitled "Global Financial Integration: Challenges and Opportunities" (A/51/388), pp. 12-16.

[5]See *OECD News Release* (11 June 1996, SG/COM/NEWS(96)63), tables 1 and 2, and OECD, *Development Cooperation*, 1995 report of the Development Assistance Committee (Paris, 1996), statistical annex, table 4.

[6]See International Monetary Fund, *International Monetary Survey* (Washington, D.C., 14 October 1996), pp. 328 and 329.