Appendix 1
Regional Economic Prospects

East Asia and Pacific

Recent developments

EAST ASIA HAS CONTINUED TO CONSOLIDATE its recovery from the deep crisis-induced recession of 1997–98, albeit with substantial variation across countries in the region. Developing countries in the region registered 6.9 percent growth in 1999, up from a decline of 1.4 percent in 1998. The Republic of Korea experienced the sharpest "V-shaped" recovery, with GDP growth of 10.7 percent in the year. Indonesia, at the other extreme, barely reached positive territory, following its difficult economic performance of 1998. On average, output in the five most affected crisis countries (Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand—known as the East Asia-5) recovered smartly at a rate of 6.7 percent from their 1998 crisis decline of 8.2 percent. China suffered a minor dip in output growth in 1999—though still growing at a clip of 7.1 percent—as recovery in exports did not occur until the second half of the year. The newly industrializing economies (NIEs—Hong Kong [China], Taiwan [China], and Singapore), which suffered substantial spillover effects of the crisis, saw a rebound to growth of 4.8 percent in 1999 from 1.1 percent in 1998. And momentum continues to be fairly strong in the region. Data covering the first three quarters of 2000 suggest that the near-term projections published nine months ago in *Global Development Finance 2000* were generally conservative, and we have upgraded the 2000 forecast for most countries. Growth for developing East Asia, in particular, is likely to be nearer to 7.2 percent than to earlier projections for 6.6 percent growth.

A common element across the region over the last 12 to 18 months has been low and stable inflation and interest rates, and these have been strong positive factors in the recovery process. For example, inflation in the East Asia-5 has stabilized at a rate of 1.5 to 2 percent, after a rapid but brief acceleration caused by the devaluation of 1997–98 (figure A1.1). Surging oil prices have translated into mild inflationary pressure in Korea (3.9 percent year on year in September) but have had considerably less impact to date in Malaysia or Thailand. As a result, monetary policy has continued to be largely accommodative, though central bank officials are carefully monitoring the situation. The low-inflation, low-interest rate environment has been particularly beneficial to the process of unwinding the domestic debt problems faced by firms and consumers in the crisis countries. Similarly, governments have been able to limit the growth of public debt (as a share of GDP) below the worst levels initially feared. Indonesia stands out from the other East Asian economies. It has been buffeted by continuing instability—the rupiah dropping 20 percent through October since the beginning of the year—and inflation started a

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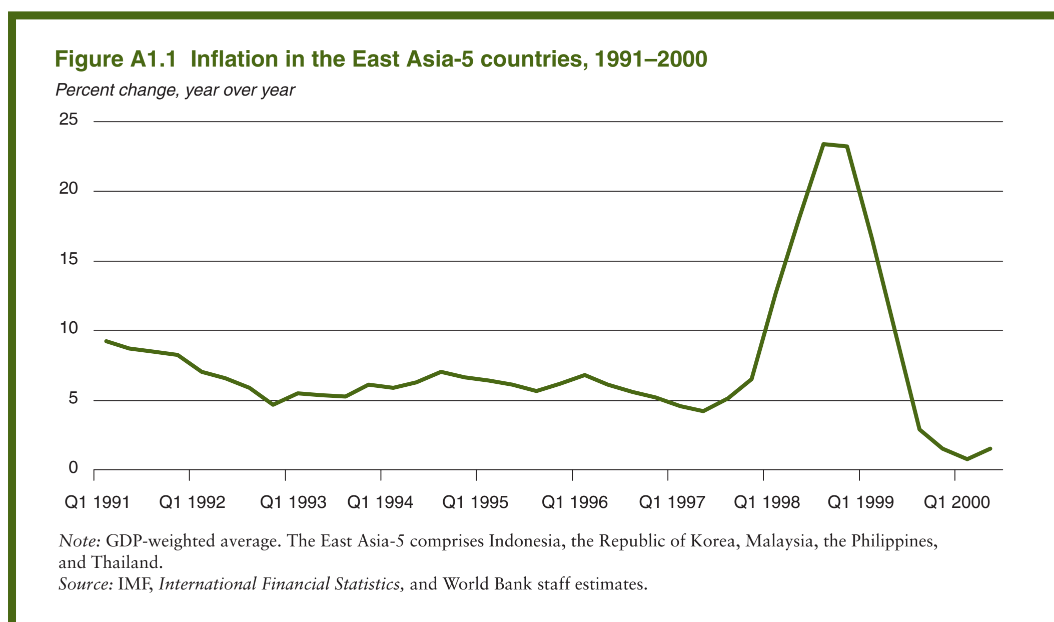

Figure A1.1 Inflation in the East Asia-5 countries, 1991–2000

Note: GDP-weighted average. The East Asia-5 comprises Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.
Source: IMF, *International Financial Statistics*, and World Bank staff estimates.

rapid rise in the third quarter (6.6 percent year on year in September).

In all the crisis countries, real effective exchange rates have stabilized at rates well above crisis troughs, but some 15 to 30 percent below precrisis levels. Thus real devaluation has persisted and facilitated a double-digit boom in exports. Robust export growth and firming export prices have abetted the maintenance of a positive current account balance, though the recovery of imports and higher oil prices has narrowed the balance in many countries. Nonetheless, rising reserves and the improved term structure of foreign debt have led to a substantial improvement in the external position of the region compared to the pre-crisis position. China's competitiveness—through maintaining stability in its own foreign exchange market—suffered in the wake of the crisis, but ultimately improved as a consequence of price deflation and VAT (value added tax) export rebates. The loss of competitiveness, combined with the sharp import reversals in the crisis countries, including Japan, led to a sharp falloff in export growth—1.7 percent in 1998 (in dollar terms), followed by 5.8 percent in 1999. Weak external demand, combined with softening internal demand as a result of reforms in the state enterprises and the financial system, led to a deflationary cycle. Deflation effectively yielded a real depreciation of the currency, and export growth has boomed since the second half of 1999, with merchandise exports 35.4 percent above year-ago levels in 2000 (year-to-date through August in dollar terms).

The main weakness in many countries has appeared in the equity markets. On average, stock market indexes in the five East Asian crisis countries declined by over 30 percent (in local currency terms) since the beginning of the year (through early November). Globally, there has been a flight to "quality" instruments, and this has depressed financial markets in almost all emerging markets. Gross financial capital inflows into East Asia appeared to have picked up in the first half of 2000 compared to 1999. However, the flows have been dominated by some large issues, particularly by China. For example, China received $10.4 billion of the regional total of $11.6 billion in equity inflow, and less than $600 million flowed into the equity markets of the East Asia-5 countries. Net flows remain negative, and in particular,

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commercial banks continue to unwind their local positions.

Near-term outlook

In 2001–02, output for the group is likely to begin a general process of moderating and converging toward longer-term growth paths, with growth easing to 6.4 percent in 2001 and 6 percent by 2002 (table A1.1). Export growth, sizzling in 2000, should ease considerably in 2001 and 2002 in line with slower external growth. External risks for East Asia are similar to what we have assessed over the last 12 months: a hard landing in the United States, a renewal of financial difficulties in Japan, and a weakening of the electronics cycle. But these risks have generally been pushed back in time. And domestic risks in aggregate have diminished from past high levels. Nonetheless, the process of working-out from under the post-crisis financial difficulties is far from finished. Higher interest rates, and/or slower growth could further worsen financial conditions for many firms and consumers still saddled with high debt. The two most vulnerable large countries are Indonesia and the Philippines. These countries also suffer from political weaknesses, civil disturbances, and a perception (from the point of view of investors), that business operating practices have not changed substantially from earlier, less than transparent modes. Some of the smaller island nations have also suffered from political turmoil (for example, Fiji and the Solomon Islands), whereas newly formed East Timor is in a slow and lengthy process of nation building.

Long-term prospects

Long-term prospects are little changed from earlier projections. Average per capita income grows in our long-term baseline (2003–10) by 5.4 percent per year—somewhat below 1990–2000 per capita growth of 5.9 percent. The factors underlying slower growth vary from country to country. The upper-middle-income countries and NIEs are converging with (or in some cases have exceeded) OECD income levels. They are maturing economies, with already highly educated work forces; and it is likely that GDP growth will ease gradually toward the OECD average over the next several years. The lower-income countries, particularly China, are unlikely to sustain the high growth rates of the past decade. Many of the low-income countries—as well as the crisis-affected middle-income countries—will have to devote resources in order to overcome the legacy of past institutional failures: addressing

Table A1.1 East Asia and Pacific forecast summary
(percent per year)

				Baseline forecast			
Growth rates/ratios	1990–2000	1998	1999	2000	2001	2002	2000–10
Real GDP growth	7.1	–1.4	6.9	7.2	6.4	6.0	6.3
Consumption per capita	5.2	–2.8	5.2	5.9	6.1	6.1	5.8
GDP per capita	5.9	–2.5	5.8	6.1	5.4	5.0	5.4
Population	1.2	1.1	1.1	1.0	0.9	0.9	0.8
Median inflation[a]	5.9	9.2	–1.0	3.8	5.4	5.8	4.8
Gross domestic investment/GDP	31.3	30.1	29.6	30.3	31.1	31.9	32.6
Median Central Gvt. budget/GD	–0.8	–2.3	–3.2	–2.8	–2.1	–1.7	–0.8
Export volume[b]	12.2	6.8	6.2	19.4	9.3	8.6	8.5
Current account/GDP	0.3	5.9	4.1	3.3	2.5	2.3	2.1
Memorandum item							
GDP East Asia-5 countries[c]	5.2	–8.2	6.7	6.9	5.5	5.1	5.5

a. GDP deflator.
b. Goods and nonfactor services.
c. Indonesia, Republic of Korea, Malaysia, Thailand, and the Philippines.
Source: World Bank baseline forecast, October 2000.

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Table A1.1a Forecast assumptions—East Asia and Pacific

Initial conditions	1988–90	1998–2000
1. Ratio of real income per capita: industrial / East Asia and Pacific	36.8	23.7
2. Trade (X+M) / GDP ratio (real)	45.3	67.2
3. Median Inflation rate (percent)	7.4	4.2
4. Median Fiscal Balance / GDP	–1.9	–1.7
5. Investment / GDP (real)	28.3	30.7
6. Investment / GDP (nominal)	29.0	31.7
7. Gross National Savings / GDP	32.9	36.6
7a. Gross Domestic Savings / GDP	34.2	38.3
8. Current Account balance / GDP	–0.1	4.2
9. FDI / GDP	1.1	3.5
10. External debt / exports*	107.3	99.7
11. School enrollment rates		
Primary (pct of eligible population)	96.0	97.0
Secondary	55.0	67.0
12. Illiteracy rate (pct of people 15+ years)	21.0	16.0
13. Under-5 mortality rate (per 1,000 live births)	55.0	43.0
14. Life Expectancy at birth (years)	67.0	69.0
Exogenous assumptions	**1990s**	**2001–10**
1. Population growth	1.2	0.9
2. Market's GDP growth	2.9	3.5
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's import growth	7.6	6.7

*Exports of goods and services plus workers remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

nonperforming loans in the financial sector, disposing of distressed assets, and reducing the state's active role in the economy while enhancing its regulatory role and competition.

Initial conditions for sustained high growth in East Asia at the beginning of the millennium appear better than at the beginning of the 1990s, the end-of-decade financial crisis notwithstanding (table A1.1a). Openness increased by more than 20 percentage points over the 1990s and was, if anything, enhanced during the crisis, presenting both an opportunity as well as a challenge. The opportunity comes from the ability to import new technologies, knowledge, and business practices. The challenge comes from increased competition and the need to develop institutions that enhance flexibility and speed of adaptation.

The countries of East Asia—with their ever increasing involvement in the so-called new economy—are well placed to meet the challenge, but they are lagging far behind the more advanced countries. In 1999, the East Asia-5 countries had only half the number of Internet hosts (per 10,000 persons) that Brazil or Mexico had, and only 5 percent compared to the NIEs. And though markets for the Internet and mobile phones have been growing at some 40 percent per year in East Asia, they have been growing at over 50 percent in Brazil and Mexico, in part as a result of deeper reforms and greater competition in the telecommunications sectors of the latter countries. There is also the possibility of reform fatigue or even reversal. Malaysia's recent decision to renege on removing import tariffs on automobiles could signal a weakening of a commitment to regional free trade.

South Asia

Recent developments

GDP growth in South Asia averaged 5.1 percent in 1997–98, as the larger economies—relatively closed to international trade—were successful in mitigating losses of agricultural income tied to commodity price declines in the wake of the East Asian crisis. Output growth accelerated to 5.7 percent in 1999 and is estimated to reach 6 percent in 2000. Better-than-expected agricultural sector performance in Bangladesh, India, and Pakistan, has accounted for a fairly large proportion of the recent improvement in growth outturns. In addition, the rate of growth in industrial production in Bangladesh and India climbed to more than 10 percent during the first half of 2000 (figure A1.2). Output in Bangladesh was boosted by the recovery from the massive flooding of 1998. The burgeoning Indian service sector also has maintained strong advances, at rates of more than 8 percent through 1999 and into 2000. Exports of goods and services continue to grow at rapid rates—by more than 10 percent in India, Pakistan,

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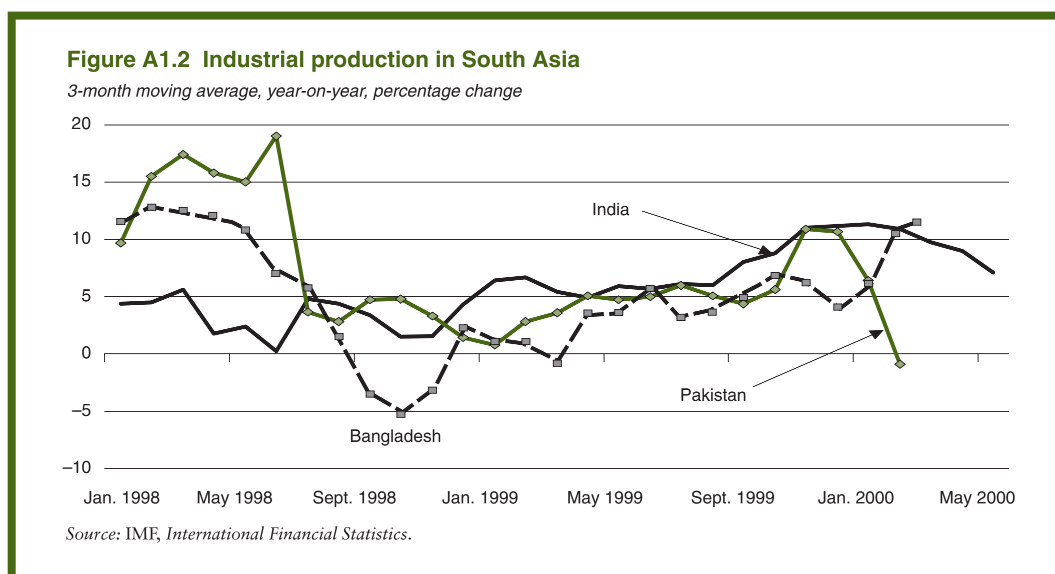
Figure A1.2 Industrial production in South Asia

3-month moving average, year-on-year, percentage change



Source: IMF, *International Financial Statistics.*

and Sri Lanka. At the same time, manufacturing production has fallen sharply in Pakistan, given financial constraints and other difficulties. And the surge in the oil price and continued weakness in non-oil commodity prices (for example, the prices of Sri Lanka's main export commodities—tea and natural rubber—are now some 20 and 30 percent below recent highs) is exacting a moderate toll from the region's growth momentum.

Recent steps to make South Asian economies more open to capital flows and strengthen the financial system have also supported growth. India eased some restrictions on FDI to encourage foreign flows into the energy sector, where it is most needed. FDI registered $2.2 billion in 1999 and is expected to achieve similar levels in 2000. But foreign investment is broadening in scope across the economy, supplementing domestic investment in such sectors as the software industry, which has achieved remarkable growth of almost 50 percent over the last year. Portfolio flows to India also increased, to a high of $3 billion in 1999–2000, attracted by (and contributing to) the boom in India's stock market. Equity prices increased by more than 50 percent from the first quarter of 1999 to the first quarter of 2000, and capitalization rose to $210 billion. Recently, however, in tandem with global financial volatility, there was a reversal of portfolio flows, which affected the stock market and exerted some pressure on the rupee. Nonetheless, steps toward improving supervision and restructuring of the banking systems in India, Pakistan, and Sri Lanka have yielded some positive results and have improved confidence in the region to a degree.

Near-term outlook

Average growth for 2001–02 is anticipated to be 5.5 percent for the region (table A1.2). Underlying this aggregate figure, however, are a number of driving and restraining forces shaping the near-term view. Among positive factors are improved prospects for capital inflows, as the Indian government in particular undertakes efforts to boost foreign investment and relax direct exchange controls. And to facilitate the growth of services exports, legislation has been introduced to support the IT sector and develop "e-business." External factors such as continued strong advances in world trade and prospects for an eventual moderate firming of non-oil commodity prices should support growth across countries of the region, especially in Bangladesh and Sri Lanka.

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Table A1.2 South Asia forecast summary

(percent per year)

				Baseline forecast			
Growth rates/ratios	1990–2000	1998	1999	2000	2001	2002	2000–10
Real GDP growth	5.4	5.6	5.7	6.0	5.5	5.5	5.4
Consumption per capita	3.5	6.7	3.5	3.7	3.3	3.5	3.6
GDP per capita	3.5	3.7	3.8	4.0	3.7	3.8	3.9
Population	1.9	1.8	1.8	1.8	1.7	1.7	1.5
Median inflation[a]	8.2	8.3	9.8	5.4	5.1	5.0	5.8
Gross domestic investment/GDP	22.2	23.0	23.3	23.7	24.1	24.3	25.0
Median central govt. budget/GDP	–6.9	–5.8	–4.9	–4.7	–4.5	–4.4	–3.7
Export volume[b]	9.9	6.4	4.9	11.5	4.4	8.4	7.9
Current account/GDP	–1.8	–2.3	–1.6	–2.6	–2.9	–2.2	–3.0

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank baseline forecast, October 2000.

Recent developments in oil markets will restrain growth in the near term, however. South Asia is one of the more energy import–intensive developing regions, with crude oil and other energy commodities constituting 20 percent of total imports in India and 15 percent in Pakistan (representing 2 percent of GDP in both countries). The 50 percent rise in the oil price over the past year has increased India's import bill by some $4 billion and Pakistan's by $650 million, increasing pressure on balance of payments positions, especially for Pakistan, where external financing difficulties are expected to continue. Moreover, uncertainty generated by the high debt levels and precarious fiscal position of central and state governments is likely to constrain private sector activity.

Long-term prospects

Average GDP growth for South Asia over the 2003–10 period is anticipated to register 5.4 percent, about 0.3 percentage points higher than in projections prepared one year ago. This pace of output growth, combined with declining rates of population growth, should support advances in per capita incomes of close to 4 percent per year over the 2000–10 period, a marked improvement over the 1990s record of 3.5 percent growth (table A1.2). South Asia begins the new decade after having achieved some progress in a number of areas supportive of longer-term growth (table A1.2a). Although the region remains in large part closed to foreign trade (in part because of the large scale of the Indian domestic economy), median inflation and central government fiscal deficits have declined modestly; external debt ratios have been brought down significantly, and domestic investment and FDI as a share of GDP have increased from generally low levels. Indicators of human capital have also improved, with school enrollment rates rising, illiteracy falling, and life expectancy increasing by three years over the last decade.

Estimates for longer-term growth assume that the region's high potential, as embodied in the initial conditions above, will be fully used. Relative to the 1990s, total factor productivity in India, for example, is expected to continue growing at a slightly higher base (by 0.2 percent) in the next decade. The abundant supply of Indian workers with training in high technology sectors should continue to provide strong momentum to the software industry. Total investment is expected to maintain growth of 8 percent throughout the next decade, with most growth emanating from the private sector. Demand for the region's exports is expected to continue to grow rapidly, with import growth in South Asia's principal

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Table A1.2a Forecast assumptions—South Asia

Initial conditions	1988–90	1998–2000
1. Ratio of real income per capita: industrial / South Asia	47.2	39.3
2. Trade (X+M) / GDP ratio (real)	13.6	19.7
3. Median Inflation rate (percent)	8.6	7.8
4. Median Fiscal Balance / GDP	–6.7	–5.4
5. Investment / GDP (real)	20.4	22.7
6. Investment / GDP (nominal)	21.0	22.0
7. Gross National Savings / GDP	19.8	19.9
7a. Gross Domestic Savings / GDP	18.8	19.0
8. Current Account balance / GDP	–2.6	–1.5
9. FDI / GDP	0.1	0.6
10. External debt / exports*	311.5	175.8
11. School enrollment rates		
Primary (pct of eligible population)	66.0	73.0
Secondary	52.0	55.0
12. Illiteracy rate (pct of people 15+ years)	53.0	47.0
13. Under-5 mortality rate (per 1,000 live births)	121.0	89.0
14. Life Expectancy at birth (years)	59.0	62.0
Exogenous assumptions	**1990s**	**2001–10**
1. Population growth	1.9	1.5
2. Market's GDP growth	2.2	3.2
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's import growth	6.0	6.2

*Exports of goods and services plus workers remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

export markets rising from 6 percent in the 1990s to 6.2 percent over 2000–10. Intraregional trade and economic integration with the world are assumed to accelerate as an easing of import substitution policies and trade and industrial restrictions takes place. Smaller countries such as Bhutan, Maldives, Nepal, and Sri Lanka will benefit from the reduction in larger-country import barriers. But an important factor likely to restrain growth is the dependency of the region—and especially the smaller countries—on a limited number of export crops, for example, cotton, tea, and rubber. Volatility and secular decline in commodity prices are likely to continue to pressure merchandise export receipts.

However, countries such as India and Pakistan face major challenges in achieving the potential rate of output growth over the next decade. High levels of domestic debt and large fiscal deficits present substantial difficulties in achieving fiscal consolidation while maintaining expenditures that are necessary for growth. A reduction in unproductive subsidies and stepped-up investment in human capital and infrastructure are essential to this effort. Infrastructure bottlenecks and delays in privatization may limit the acceleration of growth in the real and financial sectors. Also, much remains to be done to improve the competitiveness of the region's export industries. The increased focus of the government of India on trade liberalization has coincided with some increases in tariffs and an intensified use of anti-dumping measures. High tariff rates, for example, an average of 40 percent for all goods in India in 1999–2000, limit exporters' access to cheaper, more efficient industrial inputs, and serve in the long term to limit productivity gains.

Latin America and the Caribbean

Recent developments

The economic recovery in Latin America has been broadly favorable, with the region's GDP expected to rise by 4 percent in 2000. Stabilization of global financial markets and the burgeoning of world trade growth have come to support a general resumption of economic activity across the region. As in East Asia, this has been complemented on the domestic front by a steady improvement in most macroeconomic indicators through the course of 2000. Inflation declined or held steady in most countries (Ecuador was a notable exception), allowing interest rates to continue on a falling trend. Unemployment dropped and real wages rose in Brazil, Chile, and Mexico compared with 1999 averages, but unemployment remains high in Argentina and Colombia. Ex-

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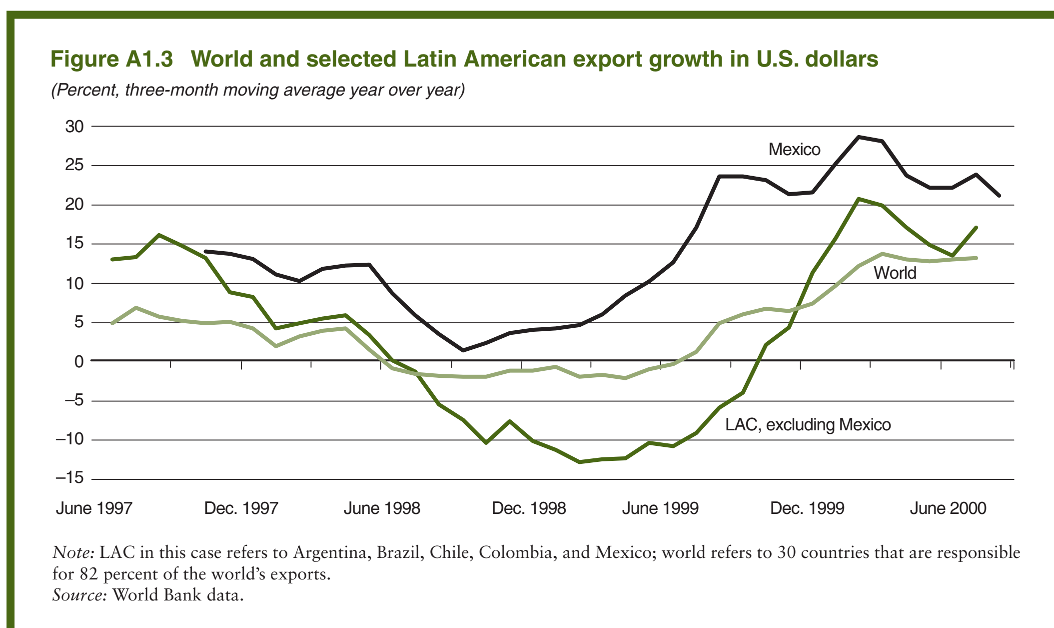

Note: LAC in this case refers to Argentina, Brazil, Chile, Colombia, and Mexico; world refers to 30 countries that are responsible for 82 percent of the world's exports.
Source: World Bank data.

change rates stabilized in several countries that experienced periods of freefall during 1999 (such as Brazil and Ecuador), restoring a degree of purchasing power and improving the outlook for private consumption and investment spending.

In real terms, most exchange rates have appreciated in 2000, but they are still low enough to facilitate rapid export growth in countries such as Brazil, Chile, Colombia, and Peru, leading to an improvement in trade balances for most countries (including oil importers). Merchandise exports in dollar terms from the region's largest economies (excluding Mexico) exhibited a sharp recovery from the lows experienced in 1998, growing by over 17 percent year on year during January–June 2000; Mexico's exports advanced by 25 percent (figure A1.3).

Mexico is an exception within the region with respect to the positioning of countries on the recovery and growth cycle. Whereas most Latin American countries experienced negative or slow growth in 1999 because of fallout from the Asian and Brazilian crises, Mexico benefited from its special trading relations through NAFTA with the United States, which remained the "engine" for world activity through this period. Mexican growth has continued to be buoyed by the U.S. import boom in 1999–2000, with business cycles in the two countries becoming more closely aligned—and likely reaching high points in 2000. In addition, the usual exchange rate difficulties that Mexico experienced with earlier electoral cycles was noticeably absent this time, in part because of prudent macroeconomic policies that helped to restrain inflation under 10 percent for the first time since the 1994 peso devaluation. As Mexico approaches a peak in its growth cycle, while others are escaping the trough, an implication is that near-term growth (2000–01) for Latin America as a whole is unlikely to display the distinct V-shaped pattern of recovery evident in East Asia.

Near-term outlook

Volatility in financial markets and primary commodity prices continues to pose a threat to the recovery in Latin America. Sharply declining equity prices during the first half of 2000 contributed to a period of uncertainty in global financial markets at a time when key commodity price movements for the region also di-

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Table A1.3 Latin America and the Caribbean forecast summary

(percent per year)

				Baseline forecast			
Growth rates/ratios	1990–2000	1998	1999	2000	2001	2002	2000–10
Real GDP growth	3.4	2.0	0.1	4.0	4.1	4.3	4.3
Consumption per capita	0.9	0.8	–2.9	1.8	2.3	2.6	2.3
GDP per capita	1.7	0.4	–1.5	2.4	2.5	2.8	3.0
Population	1.7	1.6	1.6	1.6	1.6	1.5	1.4
Median inflation[a]	16.6	7.6	9.3	8.2	9.0	7.0	7.2
Gross domestic investment/GDP	19.4	20.9	19.5	19.8	20.3	20.8	21.7
Median Central Gvt. budget/GDP	–2.8	–2.3	–2.9	–1.9	–2.0	–2.0	–1.3
Export volume[b]	8.4	7.5	7.0	8.9	7.8	7.3	7.0
Current account/GDP	–2.3	–4.0	–2.9	–2.8	–2.6	–2.6	–2.0

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank baseline forecast, October 2000.

verged. The oil price rose sharply, while non-energy commodity prices of importance to the region weakened—particularly coffee, grains, and soybeans. Although most of the large countries experienced strong gains in industrial output in the first quarter of 2000, the recovery appeared to have faltered in the second quarter, except for the oil exporters Ecuador and Venezuela. And private capital inflows fell dramatically. Argentina was particularly hard hit by these developments as they coincided with strong fiscal adjustment and a political crisis that weakened investor confidence and delayed the economic recovery. Nonetheless, consolidation of the region's recovery in 2001–02 is likely, as adjustment in Brazil has been impressive so far, and new governments in Argentina and Mexico appear set to embark on a path of deepened reforms. Global conditions are expected to remain supportive of growth in the region, with above-average world trade growth, gradual recovery in key non-oil commodity prices, declining but still moderately high oil prices, and a modest increase in private capital flows. The Caribbean islands, with their increasing reliance on tourism revenues, are also expected to benefit from moderately strong income growth in North America and Europe over the next two years. Latin American region

Table A1.3a Forecast assumptions—Latin America and the Caribbean

Initial conditions	1988–90	1998–2000
1. Ratio of real income per capita: industrial / Latin America	9.6	10.0
2. Trade (X+M) / GDP ratio (real)	26.7	51.5
3. Median Inflation rate (percent)	24.4	6.1
4. Median Fiscal Balance / GDP	–1.4	–2.3
5. Investment / GDP (real)	18.4	20.2
6. Investment / GDP (nominal)	21.4	19.9
7. Gross National Savings / GDP	20.3	17.4
7a. Gross Domestic Savings / GDP	23.9	19.3
8. Current Account balance / GDP	–0.7	–3.6
9. FDI / GDP	0.8	3.9
10. External debt / exports*	279.1	202.5
11. School enrollment rates		
Primary (pct of eligible population)	84.0	94.0
Secondary	58.0	66.0
12. Illiteracy rate (pct of people 15+ years)	15.0	12.0
13. Under-5 mortality rate (per 1,000 live births)	49.0	38.0
14. Life expectancy at birth (years)	68.0	70.0
Exogenous assumptions	**1990s**	**2000–10**
1. Population growth	1.7	1.4
2. Market's GDP growth	2.7	3.1
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's import growth	7.8	6.2

*Exports of goods and services plus workers remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

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output growth is expected to reach 4.1 percent in 2001 and to rise further to 4.3 percent by 2002 (table A1.3).

Long-term prospects

Per capita GDP growth over the long term (2003–10) is likely to average around 3 percent, about 0.2 percentage points higher than in projections prepared one year ago. Some of the elements supporting this cautious optimism are highlighted in table A1.3a and include: a definitive movement toward greater domestic macro stability, as median inflation rates dropped from 24 percent to 6 percent over the decade; a two-point increase in real investment as a share of GDP, supported by strong FDI inflows, surging from less than 1 percent to almost 4 percent of regionwide output. And openness to investment flows has been complemented by a remarkable increase in integration with global trade flows—with this measure doubling as a proportion to GDP over the last 10 years. Finally, indicators of human capital have improved, with primary and secondary school enrollment rates rising by some 10 points.

The improved state of initial conditions for the outlook joins with a more definitive trend toward market-friendly policies in the larger countries, such as Argentina, Brazil, and Mexico, and potential for technology spillovers from the United States (particularly for Mexico). Banking and financial sectors in the large economies weathered the global financial crisis of 1997–98, in part because of reforms enacted in many countries following the Mexican crisis. Further strengthening of prudential regulation and supervision should support financial deepening and help to diminish the incentives for capital flight. Finally, the strong inflows of FDI in recent years into areas of the economy that could raise growth of productivity substantially—telecommunications, utilities, ports, and so forth—should produce dividends in the next decade compared with the relatively poor performance of the last 10 years. However, there is need for more progress in financial and macroeconomic policies to deal with volatility, which may have contributed to the observed cycle of booms and busts in many countries during the 1980s and 1990s. Moreover, vulnerability of the region to swings in external financing is likely to remain a concern in the long run. Low national savings and the persistence of large debt overhangs will require rollover on a continuing basis. And this fundamental exposure to international financial conditions underlines our view that per capita growth potential is unlikely to breach 3 to 3.3 percent over the next decade, which would, nonetheless, be twice as fast as occurred during the 1990s.

Europe and Central Asia

Recent developments

GDP growth in the Europe and Central Asia region (ECA) is expected to accelerate sharply through 2000, after hitting a trough in 1998 and early 1999 following the August 1998 financial crisis in the Russian Federation. Growth in 2000 is anticipated to rise to 5.2 percent, significantly higher than the 1 percent realized in 1999. Notably, for the first time since the onset of the transition and the breakup of the Soviet Union, almost all of the countries in the region are expected to record positive growth. Short-term projections stand well above those prepared for the *Global Economic Prospects* report one year ago, primarily because of the unexpected strength of the rebound in Russia. And a common element supporting near-term growth across the region is a substantial pickup in exports, in large part because of rising import demand from the Euro Area.

In Russia, President Putin's apparent willingness to introduce reforms has eased some political uncertainties and improved business confidence. Russian industry has continued to benefit from the impact of import substitution driven by the sharp devaluation of 1998; this can be witnessed in an industrial production

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growth rate of close to 10 percent during the first half of 2000. This fillip to growth is diminishing, however, with the recent real appreciation of the ruble. An additional, more recent driver to Russia's unanticipated recovery is the windfall increase in oil and natural gas export revenues. Higher oil prices improved the fiscal balance from –4.2 percent of GDP in 1999 to +1.6 percent during the first half of 2000, and has yielded a primary surplus of 4.8 percent. This has supported continued reductions in government wage arrears, contributing to higher disposable incomes.[1] The current account surplus is expected to register close to $30 billion in 2000, or some 15 percent of GDP, boosting foreign reserve holdings considerably and easing the need for near-term external financing. Ukraine is now registering gains in output, although the political context remains difficult. For several of the hydrocarbon-rich Commonwealth of Independent States (CIS), higher oil and gas prices are providing extraordinary export earnings and contributing to higher output. Oil and gas export volumes should increase as well, as export markets (especially in Western Europe) are expected to achieve stronger growth.

The Central and Eastern European countries (CEECs) are benefiting from growing demand from Western Europe and, to a lesser degree, from Russia. This is boosting growth in Hungary (5.8 percent) and Poland (4.4 percent), in particular. In the Baltic countries, especially Estonia and Latvia, GDP growth of some 4.8 and 3.8 percent, respectively, in 2000 is also largely export-driven. However, high oil prices, combined with the depreciation of the euro, are putting additional pressure on external balances and contributing to higher inflation. Turkey's economy has continued to recover, reaching growth above 6 percent in 2000, up from the sharp 5.1 percent contraction experienced in 1999, because of a rebound in domestic demand tied to marked declines in real interest rates and reconstruction expenditures in the wake of the 1999 earthquake. Business confidence has also improved in response to implementation of an IMF-sponsored stabilization program begun in January 2000. Recent data, however, show that the current account deficit will be larger than targeted, reflecting strong domestic growth, real exchange rate appreciation and higher oil prices.

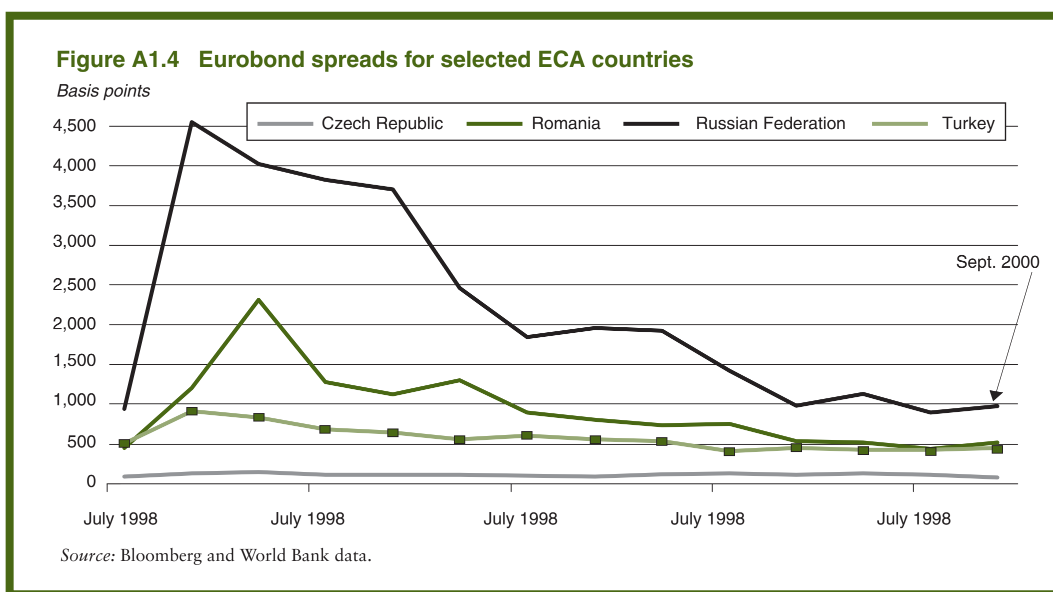

Figure A1.4 Eurobond spreads for selected ECA countries

Source: Bloomberg and World Bank data.

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Table A1.4 Europe and Central Asia forecast summary
(percent per year)

Growth rates/ratios	1990–2000	1998	1999	Baseline forecast 2000	2001	2002	2000–10
Real GDP growth	–1.9	0.0	1.0	5.2	4.3	3.9	4.1
Consumption per capita	–1.7	1.1	1.5	4.9	4.1	3.6	4.2
GDP per capita	–2.0	–0.1	0.9	5.1	4.2	3.8	4.1
Population	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Median inflation[a]	23.3	12.9	8.4	8.0	6.9	5.5	4.6
Gross domestic investment/GDP	25.2	23.0	22.1	22.6	22.9	23.1	23.6
Median Central Gvt budget/GDP	–3.9	–5.0	–4.5	–4.0	–3.7	–3.5	–3.6
Export volume[b]	0.7	7.1	1.0	8.3	6.5	6.4	6.8
Current account/GDP	–0.1	–1.7	1.6	2.8	1.4	0.6	–1.3
Memorandum item							
GDP Central and Eastern Europe	1.5	2.5	2.5	3.9	3.9	4.2	4.4
GDP CIS states	–4.9	–3.3	2.6	5.9	4.5	3.3	3.5

a. GDP deflator.
b. Goods and nonfactor services.
Source: World Bank baseline forecast, October 2000.

In most ECA countries, exchange rates have broadly stabilized since mid- to late 1999, and inflationary pressures remain largely under control. Early in 2000, several currencies faced upward pressure against the euro, including the Polish zloty, the Czech and Slovak koruny, as well as the Turkish lira following the introduction of a crawling peg regime at the beginning of the year. Interest rates have eased in Turkey and in Russia, where higher fiscal revenues have reduced pressures on central bank financing. Interest rates have been reduced in the Czech Republic and Hungary to stimulate domestic demand, in contrast with rate increases in Poland intended to slow domestic demand and import growth. Investor perceptions of potentially improved prospects for the region, including reduced political uncertainty in Russia, have led to a large decline in spreads on secondary market bonds (figure A1.4).

Near-term outlook

Growth performance for the region through 2002 is expected to remain relatively strong in the aggregate (table A1.4). Output growth is expected to stabilize near 4 percent over 2001–02. The moderate slowdown reflects short-term effects of structural reforms in a

Table A1.4a Forecast assumptions—Europe and Central Asia

Initial conditions	1988–90	1998–2000
1. Ratio of real income per capita: industrial / Europe and Central Asia	6.9	11.6
2. Trade (X+M) / GDP ratio (real)	27.2	58.3
3. Median Inflation rate (real)	43.2	10.5
4. Median Fiscal Balance / GDP	–2.3	–2.0
5. Investment / GDP (real)	28.4	22.1
6. Investment / GDP (nominal)	27.1	20.7
7. Gross National Savings / GDP	29.1	18.7
7a. Gross Domestic Savings / GDP	28.6	21.9
8. Current Account balance / GDP	2.1	–1.2
9. FDI / GDP	0.1	2.3
10. External debt / exports*	128.8	133.7
11. School enrollment rates		
Primary (pct of eligible population)	86.0	93.0
Secondary	83.0	81.0
12. Illiteracy rate (pct of people 15+ years)	4.0	4.0
13. Under-5 mortality rate (per 1,000 live births)	34.0	26.0
14. Life expectancy at birth (years)	69.0	69.0
Exogenous assumptions	**1990s**	**2001–10**
1. Population growth	0.2	0.1
2. Market's GDP growth	0.3	3.3
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's import growth	4.0	5.8

*Exports of goods and services plus workers remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

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number of countries; a tightening of policy to avoid overheating in a few Central European countries; and anticipated easing of energy prices, affecting CIS performance. But developments in export markets, policy changes related to European Union (EU) accession, and the highly uncertain path of the oil price will be critical factors in shaping the outlook.

Output among the CEECs is expected to pick up in 2001–02 to 3.9 and 4.2 percent respectively, as export markets remain firm and deeper domestic reforms contribute to improved macro stability and continued dynamism of the private sector. These countries should continue to attract high levels of FDI flows, linked tightly to the EU accession process.[2] Although fiscal and current account pressures will remain high in most of the CEECs, they are expected to ease gradually because of policies that converge more rapidly with Western European norms. In contrast, the outlook for Russia and other hydrocarbon exporters of the CIS is particularly uncertain, given the state of flux in current and prospective oil market developments. Growth in these countries is expected to slow moderately in 2001, with sharper deceleration possible in 2002, as oil prices retreat from current high levels (see the commodities section of this report).

Long-term prospects

The coming decade is likely to be characterized by substantially higher average growth rates than witnessed during the difficult initial transition period of the 1990s. As is apparent, relative performance of countries within ECA has varied tremendously over the last decade, with Poland having re-attained pre-transition GDP levels by 1996, while Russia and Ukraine still languish some 40 percent below that level. Despite less-than-satisfactory outturns in a number of transition countries, there has been a degree of underlying progress in strengthening some of the fundamentals for longer-term growth (table A1.4a). Median inflation is now one-quarter of its 1988–90 value, while fiscal balances have been maintained at moderate levels. FDI has risen as a share of regional GDP from 0.1 percent to 2.3 percent (though largely concentrated in the CEECs), and trade openness has doubled, reflecting earlier western reorientation of trade and a nascent recovery of intraregion flows. A principal area of weakness, particularly in contrast with other emerging-market regions, remains the paucity of investment, and there has been a 10–percentage point decline in gross national saving over the period. Despite increasing inequality in Russia and other CIS countries, the basic quality of the labor force remains potentially strong, and it is an asset that, combined with improved physical capital, could sow the seeds for more rapid growth in productivity and living standards.

Given these initial conditions, GDP for the region is projected to expand at a fairly robust 4.1 percent per year for the period 2000–10, contrasted with its decline of –1.9 percent over 1990–2000. But the regionwide forecast again masks expected divergences in growth outcomes at the country level. Countries anchored by the EU accession process have achieved a greater degree of stability and realignment of institutions and markets, positioning them for stronger growth compared to most of the states of the CIS, which have not wholly supported reform as extensively. The current long-term projection for the region is more optimistic than that presented in forecasts of one year ago (3.4 percent average GDP growth for the period 1999–2008)—a revision taking into account three main factors.

The new projections reflect a substantively revised assumption that over the near to medium term, Russia's new administration will be partly successful in improving economic management and in implementing recently proposed social and economic reforms. And growth prospects in the CEECs will begin to reflect benefits associated with the December 1999 Helsinki Accord of the European Commission, a decision to extend invitations for EU membership to Bulgaria, Latvia, Lithuania, Romania, the Slovak Republic, and Turkey. (This is in addition to invitations previously extended to the "early accessors": the Czech Republic, Estonia, Hungary, Poland,

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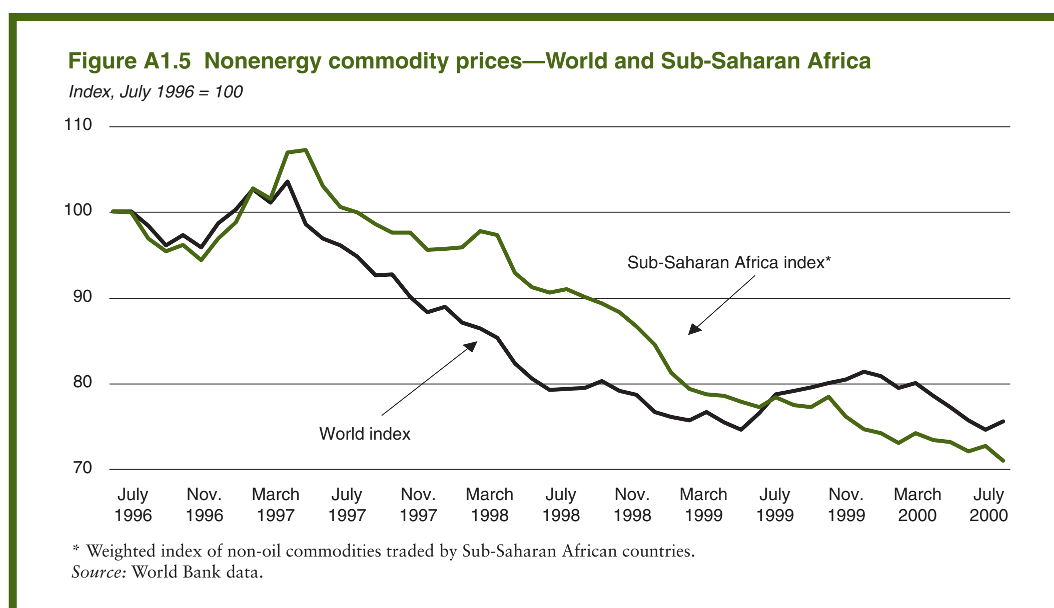
Figure A1.5 Nonenergy commodity prices—World and Sub-Saharan Africa



* Weighted index of non-oil commodities traded by Sub-Saharan African countries.
Source: World Bank data.

and Slovenia.) Finally, the somewhat higher trajectory of growth in world trade and Western European output in the new baseline has a positive impact on expansion in the ECA region.

Despite the upward revision in aggregate growth, there are a number of downside risks. In Russia, risks center on the extent to which the new government will be able to transform the current windfall gains into long-term growth. Policy measures among the EU candidate countries have contributed to increased economic stability and have helped attract substantial foreign capital. But policy mismanagement could expose the CEECs to a sharp reversal of these inflows. There is also a risk that disputes within the European Commission over reforms to its institutions, decisionmaking procedures, and budget and agricultural subsidies—which must be undertaken to accommodate an expanded membership—could delay the accession process, thus deterring foreign investors. Similarly, within the applicant countries, as more contentious reforms are introduced, political support for joining the EU may diminish, potentially slowing the accession process and growth within these countries.

Sub-Saharan Africa

Recent developments

Fallout from the 1997–99 crisis continued to exert a dampening effect on much of the Sub-Saharan African economy in 2000, as non-oil commodity export prices continued to decline over the first half of the year (figure A1.5). But higher oil revenues boosted growth for the region's oil exporters, while South Africa also strengthened modestly to 2.2 percent growth following several years of subdued performance. These and other supporting factors helped to raise GDP growth to an estimated 2.7 percent from 2.1 percent in 1999, and per capita income rose by 0.2 percent.

Substantial variation in performance was apparent across the region. Countries with better policy environments—Botswana, Uganda, and the Communauté Financière Africaine countries (excluding Côte d'Ivoire)—tended to perform better than average, with GDP up 4.4 percent. Oil producers benefited from buoyant export receipts and strong investment and grew by 3.5 percent. In East and southern Africa, many countries lagged behind. The

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Table A1.5 Sub-Saharan Africa forecast
(percent per year)

Growth rates/ratios	1990–2000	1998	1999	2000	2001	2002	2000–10
				Baseline forecast			
Real GDP growth	2.1	2.0	2.1	2.7	3.4	3.7	3.6
Consumption per capita	–0.6	–0.6	–1.0	0.3	0.6	0.6	0.8
GDP per capita	–0.6	–0.5	–0.3	0.2	0.9	1.3	1.3
Population	2.6	2.6	2.5	2.5	2.5	2.4	2.3
Median inflation[a]	10.4	5.3	5.1	4.3	3.6	3.5	4.1
Gross domestic investment/GDP	19.5	20.5	19.9	20.1	20.7	21.0	21.9
Median Central Gvt. budget/GDP	–3.7	–3.3	–3.0	–2.9	–2.4	–2.0	–1.8
Export volume[b]	4.6	0.7	2.4	6.1	5.3	5.9	6.0
Current account/GDP	–1.5	–3.5	–2.3	–2.7	–2.2	–3.1	–3.1
Memorandum item							
GDP Major oil exporters[c]	2.5	2.3	3.2	3.5	4.0	3.8	3.8
GDP Region × S. Africa/Oil-X	2.6	3.6	2.9	3.0	3.6	4.1	4.1

a. GDP deflator.
b. Goods and nonfactor services.
c. Angola, Gabon and Nigeria.
Source: World Bank baseline forecast, October 2000.

weather was partly to blame, as drought in Kenya and Ethiopia, floods in Mozambique and South Africa, and hurricanes in Mauritius contributed to a string of disappointing results. Countries experiencing civil strife or major political disruption—the Democratic Republic of Congo, Ethiopia, Sierra Leone, and Zimbabwe—registered the weakest performances, with GDP falling 1.5 percent during the year.

A strong rise in oil-related export revenue particularly afforded some breathing space to Nigeria's new, democratically elected government. While the country faces enormous short-term problems, a much needed boost to government revenues and strong foreign investment inflows underwrote growth of some 3.1 percent and yielded a sharp improvement in the balance of payments and fiscal accounts. This is helping to tide the country over until a possible resumption of International Monetary Fund lending and hoped-for debt relief. In South Africa, a weak performance by agriculture was the main cause of growth that was somewhat below expectations, though the country also experienced renewed turbulence in financial markets, as investor sentiment turned negative in the fourth quarter of 1999 and remained so through the first half of 2000. Country-specific factors, especially concern over the value of the rand and political developments in the region, were mainly responsible. A conservative fiscal stance helped to reinforce foreign confidence, though a second successive year of declining real public consumption did nothing to counter the weakness elsewhere in the economy.

Near-term outlook

Sub-Saharan Africa should further consolidate its recovery, as growth accelerates to 3.4 percent in 2001 and 3.7 percent in 2002 (table A1.5). Oil exporters will benefit from prices that are expected to remain at high levels through 2002. Further, Angola, Equatorial Guinea, Nigeria, and Sudan are all scheduled to bring additional supplies and exports onstream.[3] However, these gains will in part be offset by terms-of-trade losses to many other countries in the region, especially beverage exporters, who are facing the lowest prices in a generation (see the commodities section of this report). At least, the worst is now likely over, and terms of trade are expected to stabilize or improve modestly as non-oil commodity prices begin to firm. Also, despite the price weakness, privatization and deregulation are promoting

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Table A1.5a Forecast assumptions—Sub-Saharan Africa

Initial conditions	1988–90	1998–2000
1. Ratio of real GDP per capita: Industrial / Sub-Saharan Africa	31.4	37.9
2. Trade (X+M) / GDP ratio (real)	39.0	42.9
3. Median Inflation rate (real)	10.6	7.2
4. Median Fiscal Balance / GDP	–3.4	–2.5
5. Investment / GDP (real)	16.9	17.5
6. Investment / GDP (nominal)	17.0	16.7
7. Gross National Savings / GDP	15.2	13.5
7a. Gross Domestic Savings / GDP	17.2	14.8
8. Current Account balance / GDP	–1.6	–3.5
9. FDI / GDP	0.5	1.5
10. External debt / exports*	216.9	232.0
11. School enrollment rates		
Primary (pct of eligible population)	54.0	60.0
Secondary	...	...
12. Illiteracy rate (pct of people 15+ years)	50.0	41.0
13. Under-5 mortality rate (per 1,000 live births)	155.0	151.0
14. Life expectancy at birth (years)	50.0	50.0
Exogenous assumptions	**1990s**	**2001–10**
1. Population growth	2.6	2.3
2. Market's GDP growth	2.4	3.0
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's Import growth	6.1	6.1

... Not available.
*Exports of goods and services plus workers' remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

greater supply and export growth in key markets such as cotton and cocoa in west Africa and copper in Zambia. Nevertheless, the impact on real incomes will result in weaker domestic demand and slower growth in the near term. The baseline also assumes a return to more normal weather patterns, which will further boost agricultural production and exports. Trade liberalization, particularly in COMESA, SADC, and the South African-EU FTA, should spur greater trade and regional cooperation. And finally, the Heavily Indebted Poor Countries (HIPC) Initiative is gaining momentum, with nine African countries—Benin, Burkina Faso, Cameroon, Mali, Mauritania, Mozambique, Senegal, Tanzania, and Uganda—now having received a total of close to $9 billion of relief in net present value terms. Several more African countries are expected to reach decision points in the near future.

Long-term prospects

Despite the growth slowdown of the late 1990s, recent performance continues to support the view that fundamental structural change and institutional strengthening will have a significant impact on Sub-Saharan Africa's prospects. The forecast is for a halt to the region's lengthy decline and marginalization and even for a moderate reversal. The longer term (2003–10) outlook is for sustained GDP growth—around 3.7 percent—with per capita incomes rising 1.5 percent per year. The primary driving force behind the outlook remains better governance and ongoing reforms to the policy environment. Table A1.5a highlights improvements in a number of economic outturns over the last decade that serve as the initial conditions for development into the next 10 years. Median inflation and fiscal deficits have been reduced, while moderate gains in real investment and in FDI have also been achieved. To a degree, these have been countered by a fall in savings rates and a rise in external deficits (characteristic of the secular decline in commodity prices). Increases in school enrollment and the decline in illiteracy rates are more encouraging indicators for the stock of human capital. However, HIV/AIDS is expected to carry substantial negative effects for the future labor force (see below).

Growth is likely to remain modest compared to that of other emerging regions, reflecting a range of negative factors still to be overcome, including poor transportation and communications infrastructure, low savings and private investment rates, and limited access to foreign capital (World Bank 2000). Moreover, without substantial diversification of production, economies in the region will remain overexposed to irregular weather conditions and unfavorable terms-of-trade shocks. Unfortunately, on balance, there seems very

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little prospect for achieving widespread per capita growth rates on the order of 4 or 5 percent or more, which have characterized East Asia's best performers.

Access to foreign savings may also prove problematic. Apart from the HIPC Initiative, foreign aid is likely to diminish further. The enhanced HIPC Initiative is worth nearly $30 billion in net present value terms, with some 80 percent of the program earmarked for Sub-Saharan Africa. However, even this level of resource transfer—roughly 9 percent of 1998 GDP—is small compared to the region's requirements, and it will be necessary to attract more private capital. The main potential benefit of the HIPC Initiative may be the impetus it gives toward strengthening the policy framework and poverty reduction objectives in the region.

AIDS and the economy. The forecast attempts to factor in more carefully the economic effects of HIV/AIDS—an issue of huge importance for Sub-Saharan Africa. According to U.N. estimates (UNAIDS 2000), Sub-Saharan Africa is home to 24.5 million (or 70 percent) of the 34.3 million existing cases worldwide and 12.1 million of a total of 13.2 million AIDS orphans. Moreover, the epidemic appears to be increasingly concentrated in Africa, where 4 million of the 5.5 million new infections occurred in 1999. Southern Africa is particularly affected, with Botswana, Swaziland, Zimbabwe, Lesotho, Zambia, South Africa, and Namibia having incidence rates in the adult population between 36 percent (Botswana) and 19 percent (Namibia). By contrast, incidence rates in north and western Africa are typically below 3 to 5 percent, though they range up to 8 percent in Cameroon and 11 percent in Côte d'Ivoire. The fact that victims tend to be working adults in the prime of their lives amplifies not only the tragic human impacts but the social and economic disruption as well.

Because the scale of the HIV/AIDS epidemic is unprecedented in recent history, it is difficult to gauge its macroeconomic impacts with precision. Nevertheless, a growing body of survey work has attempted to measure the effects on households and businesses, communities, and governments. Various studies have identified a wide range of costs. These include reduced household savings and labor supply caused by the expenditure of time and money in caring for sick family members or raising orphaned children; lower productivity in the business sector because of illness, absenteeism, skill shortages, and higher training costs; and diversion of government budgets from expenditure on education and infrastructure. The impacts are more severe in sectors such as transportation, construction, and power generation, where male workers live away from their families (UNAIDS 2000, pp. 26–36; Bollinger and Stover 1999). Macroeconomic impacts have been modeled using various approaches at both a regional level and in country-specific studies of Cameroon, Kenya, Swaziland, Tanzania, and Zambia. These studies yield similar estimates of the prospective cost, generally a fall in per capita growth of 1 percent or more annually for countries with high, though not the most extreme, incidence rates (Over 1992; Bollinger and Stover 1999).

Projecting the medium-term economic impact is further complicated by variations in government policy, which can have a major influence on the course of the disease. In Uganda and Zambia, concerted government efforts have helped to lower significantly incidence rates in high-risk populations (see, for example, UNAIDS 2000, p. 10). Nevertheless, until now such interventions have been all too rare. Thus, fairly pessimistic estimates of the impact on population growth and productivity must be factored in, particularly for countries where the incidence is currently high, a category that includes some of Sub-Saharan Africa's consistently strongest performers. In the worst-affected countries, population growth is expected to slow by 1 to 2 percent annually (possibly even to turn negative), while per capita income growth may slow by nearly that much again.

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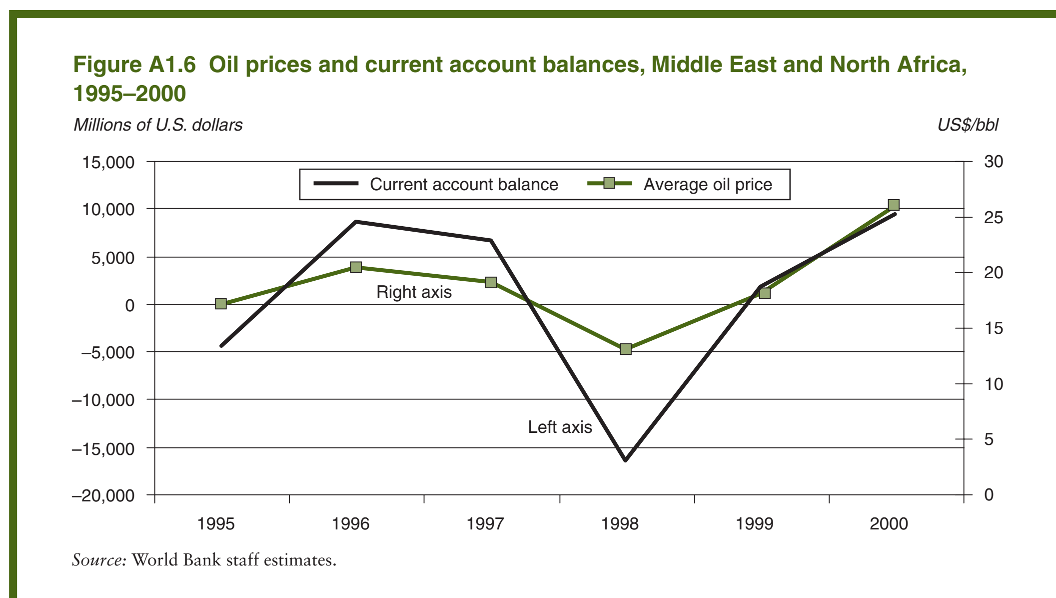
Figure A1.6 Oil prices and current account balances, Middle East and North Africa, 1995–2000



Source: World Bank staff estimates.

Middle East and North Africa

Recent developments

Despite some favorable developments, including higher oil prices, the Middle East and North Africa region's growth prospects remain modest in the short and medium terms. Adverse developments in the Middle East peace process are also casting a renewed pall on prospects for tourism, investment, and trade in the Levant. GDP growth of 2.2 percent was reported in 1999, and growth of 3.1 percent is expected in 2000. Cyclical factors have played a role in the region's recovery, with external factors such as the surge in oil prices, recovery in traditional export markets—especially the Euro Area—and some improvement in weather conditions beginning to relieve drought; these factors are leading to modest improvements in growth outturns. But significant impediments to higher potential growth remain, as the countries in the region face major challenges in the reform of domestic policies affecting trade openness, exchange rates, investment, and the labor force.

Oil prices remained above $30 per barrel for much longer than anticipated in 2000, raising export revenues and incomes in the oil exporters. As OPEC increased production quotas, export volumes have risen, and most OPEC countries are now producing at peak capacity. The impact on fiscal positions has been favorable; major oil producers had formulated budgets around an assumed oil price of $22 per barrel, and higher revenues have contributed to lower deficits and borrowing requirements. For example, in 1999 Kuwaiti oil revenues grew by 39 percent and public revenues increased by 30 percent. External debt–financing constraints have eased and domestic arrears have fallen. In Saudi Arabia, bank claims on the public sector had grown by 7.7 percent in 1998 and 3.5 percent in 1999, but fell by 8 percent in May 2000. As a result, pressure on exchange rates that were experienced in 1998 and early 1999 in several Gulf countries have eased significantly, and monetary authorities in most oil-exporting countries have built up sufficient foreign reserves to defend their exchange rate pegs. Current account positions have shown large improvement, with a turnaround of over $42 billion between 1998 and 2000, representing about 6 percent of oil exporters' annual GDP (figure A1.6). Increased imports by the Islamic Republic of Iran and Al-

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geria have diminished the magnitude of the region's surplus to a degree.

For the diversified exporters, favorable external conditions have been largely overshadowed by negative domestic effects. Growth rose somewhat to 3.6 percent in 2000 from 3.3 percent during 1999. Strong growth in Europe has fueled a boom in tourism, with record numbers of tourist arrivals and receipts being experienced in many North African and Mediterranean countries. Tourist arrivals increased by 37 percent in the Arab Republic of Egypt, rose to a record 4.8 million in Tunisia, and are rising by 10 percent year on year in Jordan for the first four months of 2000. The economic revival in Europe has also led to gains in some export categories (food and primary commodities, some mechanical goods, and energy), but exports of labor-intensive goods such as textiles and clothing remain flat in value terms. Workers' remittances have also been boosted (75 percent in 1999 in Tunisia) by the improvement in economic activity in the broader Euro-Mediterranean and Gulf regions. The gradual easing of drought conditions in many countries improved agricultural incomes and exports and led to some decline in food imports. But drought conditions have continued in Morocco for the second consecutive year, with a significant impact on overall growth. Price stability in many diversified exporters has been maintained in a time of higher oil prices through energy subsidies to domestic consumers and maintenance of tight monetary policy in support of fixed exchange rate pegs to dollar-dominated baskets. However, there are some troubling elements in the picture for diversified exporters that are limiting GDP growth:

- Exchange rates in many countries are pegged to an appreciating dollar, but these countries' major export markets are in the Euro Area. Prices in the region are rising more rapidly than in the United States, implying that exchange rates are becoming overvalued relative to other currencies. As a result, export growth is generally lower than export market growth would suggest, and several countries, particularly Egypt, are experiencing pressures on their exchange rates.
- Lower confidence in the group stemming from both economic and political factors is a second force restraining growth. Capital

Table A1.6 Middle East and North Africa forecast summary
(percent per year)

Growth rates/ratios	1990–2000	1998	1999	Baseline forecast 2000	2001	2002	2000–10
Real GDP growth	3.1	3.3	2.2	3.1	3.8	3.6	3.6
Consumption per capita	0.4	–1.2	–0.3	1.2	1.5	1.3	1.3
GDP per capita	0.9	1.3	0.3	1.1	1.9	1.7	1.7
Population	2.2	2.0	2.0	2.0	1.9	1.9	1.9
Median inflation[a]	...	0.7	4.3	5.2	3.9	3.8	3.6
Gross domestic investment/GDP	21.6	22.0	22.3	22.6	22.8	23.1	23.7
Median Central Gvt. budget/GDP	–1.6	–3.3	–3.4	–2.0	–1.8	–1.7	–1.2
Export volume[b]	4.6	–2.5	4.2	5.6	4.5	5.1	5.3
Current account/GDP	0.4	–1.0	1.7	1.3	1.0	0.5	0.7
Memorandum item							
GDP Oil-dominant economies	2.5	0.9	1.6	3.2	3.3	2.9	3.1
GDP Diversified exporters	3.9	5.5	3.3	3.6	4.7	4.9	4.4

… Not available.
a. GDP deflator.
b. Goods and nonfactor services.
Note: Excluding Iraq.
Source: World Bank baseline forecast, October 2000.

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markets have responded with disfavor to higher-than-anticipated fiscal deficits in Egypt and Lebanon, with several downgrades undertaken by ratings agencies for Lebanon, large declines in stock market indexes (by 50 percent in Egypt from January to October), and rising spreads. Because of the effects on confidence of the recent conflict in the West Bank and Gaza, and the lower likelihood of a peace agreement in the near future in the Levant, the climate for investment (and tourism) will be poorer and GDP growth will show only modest, rather than strong, recovery in 2000.

Near-term outlook

The recent modest improvement in economic activity in 2000 and the effects of reform programs under way in many countries will influence the near-term outlook for the region favorably. Activity is expected to pick up to 3.8 percent in 2001 and to slow slightly to 3.6 percent in 2002 (table A1.6). For oil-exporting countries, the outlook is conditioned by the expected path for oil prices in the period and the lagged response to higher incomes. With an average price of $28 a barrel for 2000 and $25 in 2001, oil revenues should continue to support income growth in the oil exporters, but large domestic and external arrears and structural budget deficits imply continued need for public sector expenditure restraint and reforms. Improved agricultural conditions in Algeria and the Islamic Republic of Iran, combined with continuing attempts to privatize state industries, and planned investments in the hydrocarbons sector through both domestic and foreign investment, will make positive contributions to growth. Moreover, the gradual reform of the multiple exchange rate regime in the Islamic Republic of Iran is expected to continue, given the success of the "export" rate in recent months. In the Gulf Cooperation Council countries, continued investments in hydrocarbons, reform of investment regimes (particularly the taxation of foreign firms), and a lowering of corporate taxes generally should provide a more favorable business climate. And in a reversal of patterns of the 1990s, trade regimes are also expected to become more open, as several countries, such as Saudi Arabia and Oman, seek and gain membership in the World Trade Organization.

Table A1.6a Forecast assumptions—Middle East and North Africa

Initial conditions	1988–90	1998–2000
1. Ratio of real GDP per capita: Industrial / MENA region	8.8	9.8
2. Trade (X+M) / GDP ratio (real)	36.8	37.0
3. Median Inflation rate (percent)	13.4	2.7
4. Median Fiscal Balance / GDP	–5.0	–1.0
5. Investment / GDP (real)	23.1	23.8
6. Investment / GDP (nominal)	24.8	20.8
7. Gross National Savings / GDP	20.8	19.5
7a. Gross Domestic Savings / GDP	20.6	19.2
8. Current Account Balance / GDP	–2.1	–1.4
9. FDI / GDP	0.6	1.2
10. External debt / exports*	148.9	120.2
11. School enrollment rates		
Primary (pct of eligible population)	82.0	86.0
Secondary	59.0	66.0
12. Illiteracy rate (pct of people 15+ years)	46.0	37.0
13. Under-5 mortality rate (per 1,000 live births)	71.0	55.0
14. Life Expectancy at birth (years)	65.0	68.0
Exogenous assumptions	**1990s**	**2001–10**
1. Population growth	2.2	1.9
2. Market's GDP growth	2.6	3.2
3. Oil price $/bbl (avg.)	18.2	20.2
4. Market's import growth	6.7	6.3

*Exports of goods and services plus workers remittances.
Note: Market growth is trade-weighted partner GDP / import growth.
Source: World Bank database, World Bank staff estimates.

The near-term outlook for the diversified exporters indicates that growth will rise to 4.7 percent in 2001 and to 4.9 percent in 2002. Favorable factors assisting growth include the smooth changes in leadership in Jordan, Morocco, and the Syrian Arab Republic, which contributed to lower political uncertainty; the potential for reduction of political conflict in the Western Sahara; and efforts to jump-start the UMA (Arab Maghreb Union). The public sector in several countries will contribute significantly to growth, with bond issues in Lebanon and Egypt to finance higher fiscal expenditures. The recent gradual down-

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ward adjustment to the Egyptian pound is expected to continue into 2001, improving the prospects for net exports somewhat. Broadening of privatization programs into areas such as telecommunications, airlines, and the finance sectors in Egypt, Jordan, Tunisia, and Morocco will attract additional foreign investment, helping to deepen equity markets, and improve efficiency in operations of the sectors. However, unfavorable factors persist. The political uncertainty in the Levant appears to be continuing, with significant adverse impacts on confidence and investment. The effects on investment may be felt outside the Levant, particularly because of "wrong neighborhood" effects. Additionally, the pace of reforms in the public sector, privatization programs, and microeconomic reform in the private sector is very slow, suggesting that the gains will not be felt fully in the near term. And with the performance of the large agricultural sectors in many countries heavily reliant on weather conditions, volatility in growth resulting from unpredictable weather conditions will continue.

Long-term prospects

At this juncture, the moderately optimistic near-term picture for the region does not translate into significantly higher long-term growth potential. Despite reforms in many of the countries in the region, much of the improved performance in the recent past owes much to cyclical and external factors such as weather, oil prices, and export market–growth. Significant structural impediments to higher long-term growth remain. Table A1.6a shows that there have been fundamental (and likely secular) improvements in some regional macroeconomic conditions and in the nurturing of the labor force over the last decade. Reduction in inflation and fiscal imbalances, attraction of additional FDI flows, and lowering of external debt ratios are significant. Moreover, considerable improvements in school enrollment, reduction of illiteracy, and better health indicators are positive forward-looking indicators for the future labor force. But the region remains less open to foreign trade than others, with the exception of South Asia, with no change in the ratio of trade to GDP over a 10-year period. And investment has remained stagnant, with little improvement in private capital spending—a critical element in fostering efficiencies and contributing to higher long-term potential growth rates.

Other substantial obstacles to higher long-term growth persist. Public sectors continue to be large and inefficient in delivering services, and the institutional and regulatory capabilities in many sectors are not geared to fostering private sector development. Moreover, the region continues to rely heavily on narrow sources of external revenues, whether they are product or export-market dominated, suggesting the potential for longer-term volatility in export earnings. Overvaluation of exchange rates in several countries will continue to have dampening effects on export growth. And the problem of noncompetitiveness of basic industry will be further exacerbated by the proposed abolition of the Multifibre Agreement (MFA), which will allow greater competition by low-cost producers in traditional export markets for North African textiles and clothing.

Recent political events have cast a pall over confidence in the region, overshadowing the potential for improvements in regional integration resulting from the EU Association Agreements and peace agreements in the Levant. While tensions remain high, prospects for intraregional trade, as well as foreign investment and tourism, will be poor. Even if some form of détente is reached in the Levant, it may result in a "cold peace" where countries may not be in conflict, but the cooperation required for trade relations may be lacking. For oil exporters, the windfalls from higher oil prices are expected to be temporary, and oil prices are expected to fall in the medium term, suggesting that structural changes need to be made to improve fiscal positions and increase the scope of private activity in domestic economies. This implies that while conditions in oil markets and major trading partners are so favorable, the region should take advantage of the current trends to cast a

wider net and proceed more quickly with their domestic reform agendas.

Notes

1. The percentage of the population on wages "below subsistence" remains high at 27.6 percent, according to official estimates as of June 2000. However, it has declined significantly from 33.5 percent as of April.

2. The EU market now accounts for 60 to 80 percent of Central and Eastern European countries' exports.

3. Note that Angola, Equatorial Guinea, and Sudan are not OPEC members. For Nigeria, recent crude oil production has been marginally below the OPEC quota of 2.157 million barrels per day. However, the Obasanjo administration has ambitions to increase production well beyond the current quota limit, to 3 million barrels per day by 2003. A warming of relations with Nigeria's foreign joint venture partners and a recent surge in exploration and development activity indicate strongly that an increase of this magnitude will likely be feasible. Less problematic for relations with OPEC, a third liquid natural gas (LNG) train is scheduled to come onstream at Bonny Island in 2002, raising production by 50 percent. The additional output has already been presold. See, further, http://www.eia.doe.gov/emeu/cabs/nigeria.html.

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