

APPENDIX II

INTERNATIONAL ECONOMIC OVERVIEW AND MARKET POTENTIALS

Section B of the LATTs Main Report discussed the trade analyses that were undertaken in this study. An examination of existing trade flows was performed, followed by development of trade forecasts. The objective of these analyses was to characterize the size and composition of trade flows and to provide some indication of how much bigger they could become by 2020. The LATTs forecasts address trade flowing through the gateways of the Southeastern Alliance Region, between the US and Latin America, Asia, Europe and the rest of the world.

Fundamental to the development of LATTs forecasts was an understanding and quantification of economic conditions and outlooks regarding Latin American countries and other trading partners of the U.S. Additionally, the market potentials of these trading partners were assessed. This information provided a foundation upon which the LATTs forecasts were developed.

Presented in this Appendix are summaries of these economic and market potential reviews. The presentation is categorized as follows:

- ▶ Economic summary for all of Latin America;
- ▶ Economic and market potential reviews for each Latin American country (or groups of countries);
- ▶ Economic indicators for various world-wide regions; and
- ▶ Economic and international linkage reviews of various worldwide regions.

Because of the sequence of study tasks, these reviews and assessments were performed as an early activity in LATTs. The analyses were documented in the latter part of 1998. The latest data available at that time sometimes was for the years 1996 or 1997. With the passage of time, the information has become less timely than it was when it was produced. Further, it may be noted that the discussion sometimes makes forward-looking statements for what was then the near term future but which now is the recent past. Despite being overtaken by events, the information remains relevant for understanding the context and circumstances upon which LATTs forecasts were based.

Observations and discussions regarding foreign policy as contained herein are those of the study consultants and are not necessarily shared by the Federal Highway Administration or any other Alliance member.

LATIN AMERICA ECONOMIC SUMMARY

Key Findings

- ▶ *The region is expected to lead the world in terms of economic growth out to the year 2020.*
- ▶ *Continued political and economic reforms are key assumptions for this strong economic performance.*
- ▶ *Trade liberalization is paving the way for the creation of a major regional economic power with significant links to North America.*

A Global Growth Leader

The economic outlook for Latin America is positive. Given the success of privatization and trade liberalization programs, and the increased efficiency required in fierce open market competition, the average annual growth rate of the region's economy will exceed 4%. Due to the Asian currency crisis, Latin America is now expected to be the fastest growing region in the world over the next few years.

Emerging from an underdeveloped state, and having undergone political and economic reform, there is enormous pent-up consumer demand for various products, with spending levels and penetration rates well below those of countries with similar wealth. Income growth and restructuring will increase domestic demand for a wide range of value-added products.

Exhibit II-1

	Average Annual Growth, 1996-2020				
	Population (mil.)	Real GDP (95\$ bil.)	Nominal GDP Per Capita (\$)	Nominal Exports (\$ bil.)	Nominal Imports (\$ bil.)
Argentina	1.2%	5.2%	7.0%	10.0%	10.0%
Bahamas/Jamaica	0.9%	2.7%	4.7%	7.6%	4.5%
Bolivia	2.0%	5.2%	6.0%	6.8%	9.7%
Brazil	2.0%	4.1%	6.2%	8.8%	9.4%
Chile	1.5%	5.6%	8.2%	9.4%	9.7%
Colombia	1.5%	5.2%	5.7%	8.5%	8.5%
Cuba	0.5%	2.5%	4.9%	10.2%	9.5%
Dominican Rep	1.5%	2.1%	3.4%	9.6%	8.7%
Ecuador	2.1%	3.9%	4.0%	7.1%	7.6%
French Guiana/Guyana/Surinam	1.0%	2.4%	4.3%	4.9%	8.5%
Haiti	1.6%	1.5%	2.7%	4.2%	5.7%
Mexico	1.5%	4.4%	8.2%	13.1%	13.2%
Panama	1.3%	4.9%	6.5%	12.6%	8.0%
Paraguay	2.4%	5.0%	5.5%	7.3%	7.7%
Peru	1.9%	4.7%	2.1%	8.7%	8.5%
Uruguay	0.6%	4.5%	6.9%	6.5%	9.2%
Venezuela	2.3%	4.1%	5.1%	7.2%	10.0%
Other Caribbean	0.4%	2.6%	5.0%	1.8%	4.0%
Other Central America	2.0%	1.6%	2.5%	7.3%	7.2%
Latin America	1.8%	4.4%	6.1%	10.5%	10.3%
Canada	0.8%	2.3%	4.9%	8.5%	8.9%
Western Europe	0.4%	2.3%	4.9%	7.7%	7.7%
Asia	1.2%	3.6%	5.3%	8.3%	8.4%
Rest of World	2.2%	4.1%	4.3%	6.9%	7.0%
World*	1.3%	2.8%	4.6%	7.9%	8.0%

*The world total does not include Eastern Europe and the former Soviet Union, many countries in Asia, and most of Africa.

Exhibit II-2

	Levels, 1996				
	Population (mil.)	Real GDP (95\$ bil.)	Nominal GDP Per Capita (\$)	Nominal Exports (\$ bil.)	Nominal Imports (\$ bil.)
Argentina	35	296	8,428	18.6	22.7
Bahamas/Jamaica	3	8	3,003	3.1	4.7
Bolivia	9	7	875	1.3	2.0
Brazil	160	751	5,046	53.3	67.0
Chile	14	72	5,072	19.8	20.8
Colombia	36	81	2,372	13.5	17.0
Cuba	11	21	1,931	1.9	2.2
Dominican Rep	8	11	1,456	4.9	5.4
Ecuador	12	18	1,398	5.6	5.3
French Guiana/Guyana/Surinam	1	5	3,373	1.6	5.5
Haiti	7	2	327	0.2	1.0
Mexico	91	259	3,166	79.0	72.8
Panama	3	8	2,970	1.3	15.6
Paraguay	5	9	1,922	1.0	5.0
Peru	24	67	2,910	9.5	12.3
Uruguay	3	19	5,907	2.4	3.8
Venezuela	22	81	3,459	24.3	13.7
Other Caribbean	3	21	7,131	5.9	13.4
Other Central America	31	37	1,235	9.6	14.8
Latin America	477	1,773	3,262	256.9	305.1
Canada	30	589	20,175	235.2	212.2
Western Europe	447	9,194	20,609	2,722.6	2,542.6
Asia	2,885	8,508	2,735	1,705.4	1,704.6
Rest of World	334	550	1,674	184.4	187.0
World*	4,438	28,080	77,180	5,975.3	5,917.1

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

The expansion and improvements in infrastructure will continue to provide opportunities for the engineering services industry as well as to providers of a variety of capital investment goods. Recognizing that shortfalls in infrastructure and supporting services can hamper economic development, more governments are willing to privatize state monopolies to attract foreign investment and technology and for greater efficiency. Technological developments, notably in telecommunications, have turned infrastructure industries previously dominated by natural monopolies into competitive industries with potentially profitable investment opportunities.

Over the 1997-2020 period, total real GDP in Latin America will grow by 4.4% annually, compared to 3.6% in Asia and an average rate of 2.8% for the world. Leading the pack are five countries with growth rates over 5%: Chile, Colombia, Bolivia, Argentina, and Panama. At the other side of the spectrum, Haiti and the Central American region both have growth rates below 2%.

Nominal GDP per capita is also higher in Latin America than in other emerging markets. In 1997, the average income in Latin America was \$3,478. The equivalent average in Asia was \$2,593. Growth in GDP per capita is also forecast to be faster in Latin America, at an average annual rate of 6.0% over the forecast period. Within the region, the countries with the largest average incomes were Argentina, the Caribbean region, and Uruguay. Chile, in fifth place in terms of per capita income levels, is forecast to have the fastest growth rate.

Brazil dominates in market size, both in population and total real GDP. Although Argentina has less than half the population of Mexico, it has a larger GDP. Mexico, however, is the clear leader in trading volume. In 1997, Mexico exported and imported more than \$100 billion. With the highest growth rate in imports, and the second highest growth in exports, Mexico will grow to account for more than half of Latin American trade by 2020. Panama, with a specialization in re-exporting, will experience the fastest growth in exports over the forecast interval. Overall, trade in the Latin America region is forecast to grow over 10% annually, again placing it in first place among world regions.

Exhibit II-3

Latin America	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	477	513	612	724	1.8%	10.6%	12.0%
Real GDP (95\$ bil.)	1,773	2,114	3,322	4,999	4.4%	6.1%	9.1%
Nominal GDP Per Capita (\$)	3,262	4,003	7,217	13,361	6.1%	--	--
Nominal Exports (\$ bil.)	257	394	1,093	2,796	10.5%	4.2%	7.6%
Nominal Imports (\$ bil.)	305	485	1,280	3,188	10.3%	5.0%	8.6%

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

Recovery From the Peso Crisis

Although growth has slowed to some extent due to the Mexican peso crisis, a recommitment to the reform policies of the late 1980s and early 1990s has allowed most of the Latin American countries to weather the storm remarkably well. For this reason, continued economic development is expected for Latin America.

In the early 1990s, Latin America was one of the fastest growing regions in the world. A variety of economic, political, and social reforms were implemented that freed economies from government intervention, addressed severe poverty, and, in some cases, replaced military rule. As its economies progressed, Latin America enjoyed increases in capital flows and greater flexibility in international financial markets. Many of the newly elected government officials worked to restructure their national debt while at the same time embarking on trade liberalization and privatization programs to increase their country's presence in the world market place. The future success of these policies seemed almost certain until the Mexican peso crisis in December 1994. Economists and policymakers watched as much of their work came undone. Many of the countries in the region suffered from rapid capital flight, as foreign investors became cautious of exchange rate instability and severe inflation. Unemployment levels began to rise once again, and foreign account and fiscal deficits grew. The situation called for a recommitment to existing reform policies, because much of the work of the late 1980s and early 1990s would have to be redone.

Now, in the fourth year since the peso crisis, results vary, and most of the economies still show plenty of room for improvement. Mexico has shown significant progress in stabilizing its exchange rate and curbing inflation, but the tight money policies aimed at these objectives has, until this year, also slowed growth. Peru has had similar problems with sluggish growth, in addition to a large current account deficit that is expected to continue to grow until privatization yields higher output. Colombia and Venezuela have both made impressive gains in revitalizing growth, but these countries are plagued by political unrest that must be dealt with in order to restore investor confidence. Brazil has developed a comprehensive economic program involving everything from privatization and liberalization to the introduction of a new national currency, but still faces the challenge of banking system reform. The ability and effectiveness with which policymakers respond to these issues will determine the leaders in economic development in the years to come.

Trade Liberalization

Trade liberalization has helped to achieve greater stability in the region and boosted long-term growth. On the inflation front, the lowering of tariffs has contributed to price stability by forcing local producers to compete with cheaper imports. On the supply front, pressure is mounting for locally based producers to restructure and become more efficient in world markets by taking advantage of economies of scale and rationalizing costs. While formal tariffs have been removed on most products, non-tariff barriers are also beginning to fall. Rules on

issues such as technical standards, intellectual property, antitrust restrictions, and the environment are being harmonized. Customs procedures are also being simplified.

Trade liberalization and privatization remain the key elements to the reform strategies in Latin America. A primary example of the move toward free trade is Mexico's involvement with NAFTA. In the months following the Mexican peso crisis, Mexico relied heavily on its export revenues to pull it out of the recession, a large majority of which came from the United States and Canada. Spurred by the success of NAFTA, Mexico is currently negotiating free trade agreements to open their borders to other Latin American and European countries.

Chile seems to be following in Mexico's footsteps with its recent trade agreement with Canada. This agreement had been expected to be the preliminary step to Chile's eventual membership in NAFTA. However, the failure of the 1998-2000 effort to achieve "fast track" trade negotiation authority from Congress will delay this prospect. Chile has already shown an active interest in trade liberalization with its membership in the Asia Pacific Economic Cooperation group (APEC), as well as its efforts to become a member of Mercosur.

Mercosur is a free trade area comprised of Brazil, Argentina, Paraguay and Uruguay, with associate members Chile and Bolivia. Mercosur is a customs union that includes binding tariff preferences among members and a common external tariff on trade with non-members. With a population of 230 million and GDP of U.S.\$1.2 trillion, Mercosur is now the world's fourth largest integrated market, after NAFTA, the EU and Japan.

Significant progress has been seen in the growth of trade: from \$4.1 billion in 1990, intra-Mercosur trade quadrupled to about \$20 billion in 1997. While trade has increased partly because of greater economic stability combined with the lifting of trade barriers, much of this trade is intra-industry trade as firms exchange products or components, taking advantage of the specialization possible through the larger market. Many member countries in other trade groups are now looking at the Mercosur bloc for opportunities for export growth, as well as access to the huge Argentine and Brazilian markets.

The Andean Pact, between Bolivia, Colombia, Peru, and Venezuela, has been reasonably effective as well. The Andean Pact has as its aim the establishment of a free trade zone, a common external tariff, and eventually a full common market. In 1995, Andean Pact countries achieved 8.8% growth in exports between member countries, and growth escalated into double-digit figures last year. Members follow various tariff reduction schedules rather than a single schedule. The Andean Pact incorporates a full range of services, including professional, financial, telecommunications, and transportation.

Several other trade agreements exist in the region. The Latin American Integration Association¹ (LAIA) includes almost all South American countries as well as Mexico. LAIA was established in 1980, and grew out of previous

¹ Also known as ALADI, for *Asociación Latinoamericana de Integración*.

economic integration agreements in the region. The goals of LAIA are to promote economic cooperation and market expansion in the region. They have established regional tariff preferences and a credit mechanism designed to finance intra-regional trade.

The Group of Three, between Colombia, Mexico, and Venezuela, had a representative market of over 151 million in 1997. It became effective on January 1, 1995, with the objective of eliminating tariffs among member nations over a ten-year period. A single tariff reduction schedule is applied to 90 percent of goods. Professional services and basic telecommunication services are included in the agreement.

CARICOM is a customs union involving most of the Caribbean islands as well as Belize, Guyana, and Suriname. The objective of the agreement is the creation of a common market. The CBI, which covers both Caribbean and Central American countries, allows tariff free imports of classified merchandise into the U.S. from member countries. At least 35% of the value of goods must be attributable to one or more beneficiary countries.

CARIBCAN is a program created by the Canadian government in 1986, for trade, investment, and industrial cooperation in the Caribbean region. The program extends duty-free access to imports from Commonwealth Caribbean countries. To qualify for duty free entry into Canada, a minimum of 60% of the value of the good must originate from a member nation.

Investment Attraction

The ability to create favorable investment climates will also be of paramount importance as Latin American countries vie for the attention of foreign investors. Privatization has become the major policy tool for this objective. The new governments in Latin America are staying away from government intervention in order to open their economies to private enterprise, and let the free market determine the most efficient allocation of resources. Privatization programs have been implemented in almost all of the countries in this region, and the effects of these programs are apparent in the increased levels of foreign investment, the boost to foreign reserves from the sale of public monopolies, and the downward pressure on prices due to increased competition.

ARGENTINA

- ▶ Recent economic reforms have set the stage for stable economic growth in the medium term; real GDP growth will average 5.1% over the next 23 years.
- ▶ With the highest nominal GDP per capita among Latin American countries and continued strong growth, Argentina has strong market potential.

Exhibit II-4

Argentina	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	35.2	37.1	41.9	47.2	1.2%	7.4%	6.5%
Real GDP (95\$ bil.)	296.4	371.2	610.8	991.4	5.2%	16.7%	19.8%
Nominal GDP Per Capita (\$)	8,428	10,710	22,174	42,512	7.0%	--	--
Real Private Consumption (95\$ bil.)	235.2	289.1	451.2	689.8	4.6%	--	--
Real Public Consumption (95\$ bil.)	12.9	15.9	24.8	37.8	4.6%	--	--
Real Fixed Investment (95\$ bil.)	49.9	77.5	157.3	271.1	7.3%	--	--
Nominal Exports (\$ bil.)	18.6	25.8	69.9	184.2	10.0%	7.3%	6.6%
Nominal Imports (\$ bil.)	22.7	37.1	99.4	224.3	10.0%	7.4%	7.0%
Exchange Rate (NCU/\$)	1.00	1.00	1.00	1.00	0.0%	--	--
Rate of Inflation	0.2%	4.2%	3.6%	3.2%	3.4%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Argentina holds one of the most plentiful baskets of natural wealth in the world including fertile lands, vast energy resources, and excellent ports. Decades of political mismanagement, however, punctuated by numerous coups, have reduced Argentina from one of the ten wealthiest nations before World War I to worse than 30th in real per capita income terms today.

Under President Menem, a host of neo-liberal economic policies were implemented. Trade liberalization, the institution of a currency board, a stable currency, relatively low interest rates, and privatizations helped to tame inflation and to provide greater economic stability, both boosting investment and the economy. Despite a recession due to capital flight during the Mexican peso crisis in 1995, President Menem stuck with the neo-liberal model and currency board. Argentines have since been rewarded with strong economic growth, but they have also suffered stubbornly high unemployment rates.

The economic reform bodes well for medium-term stability, but it does not insulate Argentina perfectly from the consequences of the Asian crisis. In fact, real GDP growth, which was previously expected to decelerate to 6% in 1998, will actually come down to about 4.8%. The main reason will be that, despite the strengthening of the financial sector in the last three years, the "Brazil factor" and generally jittery international markets have increased perceived risk in Argentina, pushing interest rates significantly above their pre-Asian crisis levels. Short-term growth prospects have been adversely affected by another less important factor: Brazil absorbs nearly 30% of Argentina's total exports. The impact of the turmoil in Asia could also hurt an economy structurally dependent on foreign financial flows in numerous ways—in addition to the reduction in Brazilian imports that it will cause.

Despite the current nervousness in domestic and foreign financial markets, it remains unlikely that the peso's peg to the dollar will be abandoned in the short run. Across political lines and in the investor community, the currency board that maintains the peg is still viewed as key to Argentina's financial and macroeconomic health. In fact, there is a widespread perception that should the

worst scenario—a financial collapse in Brazil—occur, the government would swallow the bitter pill and let the economy go into recession, rather than tinker with the exchange rate regime.

The currency board regime, which limits the size of the money supply to foreign exchange reserves, will continue to keep inflation at bay. The monetary regime does present some risks, through its contribution to high unemployment rates and its vulnerability to speculative attack. At this time, it is likely that the board will remain a key part of economic policy, since all the leading political parties recognize its stabilizing force in the economy.

In the long run, despite the Asian crisis, the outlook for Argentina remains positive. Expectations are for continued strength in domestic investment and exports. Strong domestic investment and technology transfer are driving productivity gains, which in turn boosts industrial and agricultural production. Real GDP is expected to grow at an average annual growth rate of 5.1% over the next 23 years.

Market Potential

While the unemployment rate remains high, joblessness has been cut sharply by the roaring economy. There was a decline in the unemployment rate from 16.1% in May to 13.8% in October 1997. Trade liberalization, which has forced some companies to fold due to competition, and productivity growth, which has enabled greater output with fewer employees, have been two main causes of high unemployment. Argentina's inflexible labor laws are a third cause. Strong unions have made it difficult for companies to fire employees during downturns or when they do not perform well. Hence, the cost of hiring is higher as well.

Nominal GDP per capita, a rough measure of average personal income, is higher in Argentina than all other Latin American countries. At market exchange rates, it was \$8,676 in 1997. The relatively high income supports growing private and public consumption, as well as strong investment growth. Nominal GDP per capita will grow at a rate of 7.2% over the next 23 years, ranking fourth among the Latin American entities covered in this study. Population growth will average 1.2% over the forecast period.

Argentina's shift from a country with a trade surplus to a trade deficit in recent years is evidence of the impact of economic reforms and trade liberalization. Trade liberalization, begun in the early 90s, has eliminated almost non-tariff barriers and import licensing requirements, and has substantially lowered duty rates. Regional trading partners still account for the largest percentage of trade, with LAIA partners accounting for the largest share. Brazil is the largest single-country trading partner. While trade with the U.S. has grown substantially in recent years, there remains stiff competition between the U.S. and the EU for market share in Argentina. Over the next 23 years, exports are forecast to have an annual average growth rate of 10.3%, and imports will increase at a rate of 9.9%.

Argentina's full membership in Mercosur has promoted strong intra-regional trade with its Mercosur partners. Most duties and non-tariff barriers were removed between Argentina and Brazil at the end of 1994, and with the rest of the members at the end of 1995. Argentina is also a member of the Latin American Integration Association, as well as the WTO.

BAHAMAS/JAMAICA

- ▶ The combined economy of the Bahamas and Jamaica will grow at an annual average rate of 2.6% over the forecast period.

Exhibit II-5

Bahamas/Jamaica	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	2.9	3.0	3.2	3.6	0.9%	0.6%	0.5%
Real GDP (95\$ bil.)	8.4	9.6	12.8	16.0	2.7%	0.5%	0.3%
Nominal GDP Per Capita (\$)	3,003	3,576	5,618	9,028	4.7%	--	--
Nominal Exports (\$ bil.)	3.1	4.3	8.9	18.1	7.6%	1.2%	0.6%
Nominal Imports (\$ bil.)	4.7	5.3	8.3	13.6	4.5%	1.5%	0.4%

Economic Overview

The mainstays to the Bahamian economy are tourism and financial services. Indeed, the services sector accounts for approximately 90% of GDP. Recent slowdowns in the tourism industry, particularly from Europe, have led to slower growth in recent years. However, the tourism industry is improving in response to the healthy U.S. economy, as the majority of tourist visits are from the U.S.

The Jamaican economy is based on bauxite, tourism, and sugar. Economic instability in the country and mine closures in the bauxite industry, as well as low world prices, have slowed growth in recent years. An IMF program imposed on the country has helped slow inflation and stabilize the exchange rate, but at the cost of significantly slower growth and continued high unemployment. Economic reforms include the elimination of most price controls, streamlined tax schedules, and the privatization of government enterprises.

As in the Bahamas, a large percentage of the Jamaican labor force is employed in the services industry: roughly 40%. Another 22% of the labor force are employed in agriculture, and there is an estimated unemployment rate of 15%. The combined economy of Bahamas and Jamaica are forecast to grow at a relatively slow rate of 2.6% over the forecast period.

Market Potential

Real GDP per capita is below average in the region, ranking ninth among Latin American entities in the study. The large proportion of the labor force in the tourism industry—estimated at 40%—and the high unemployment rate (15%) limits income growth. Although nominal GDP per capita will grow at 4.6%

annually, in real terms it will increase only marginally. Population growth will be one of the slowest among Latin American countries.

The Bahamian dollar is fixed to the U.S. dollar, in efforts to provide a stable currency. The Bahamas export commodities such as pharmaceuticals, cement, rum, crawfish, and refined petroleum products. Manufactured goods, such as automobiles and electronics, comprise imports. The U.S. is the largest partner for both exports and imports, accounting for 22% and 39%, respectively in 1995. Most of the rest of the trade is conducted with European nations.

Over half of Jamaica's exports are bauxite products, with the remainder concentrated in food products such as sugar, bananas, and rum. Jamaica imports machinery and transportation equipment, construction materials, fuel, and food. The U.S. is again the primary trading partner for Jamaica, accounting for 43% and 57% of exports and import in 1995, respectively. Other major trading partners are the EU and Canada.

Exports from the Bahamas/Jamaica include tourism revenue, which is reflected in the strong growth forecast of 7.5% for this region. Imports will grow at a much slower rate of 4.5% in the next 23 years.

The Bahamas and Jamaica are both members of three Caribbean economic agreements: CARICOM, the Caribbean Basin Initiative (CBI), and CARIBCAN. Jamaica is also a member of the WTO and the Bahamas is an applicant.

BOLIVIA

- ▶ Economic reforms will enable Bolivia to achieve strong real GDP growth in the short term, after which it will moderate to an annual average growth rate of 5.1% over the forecast period.
- ▶ Bolivia is one of the poorest countries in Latin America. Strong GDP per capita growth will begin to improve the situation.

Exhibit II-6

Bolivia	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	8.7	9.6	12.0	14.1	2.0%	1.8%	1.9%
Real GDP (95\$ bil.)	7.4	9.9	16.7	25.0	5.2%	0.4%	0.5%
Nominal GDP Per Capita (\$)	875	1,127	1,971	3,561	6.0%	--	--
Nominal Exports (\$ bil.)	1.25	1.63	3.12	6.13	6.8%	0.5%	0.2%
Nominal Imports (\$ bil.)	2.01	3.17	7.97	18.42	9.7%	0.7%	0.6%
Exchange Rate (NCU/\$)	5.07	5.75	6.41	6.61	1.1%	--	--
Rate of Inflation	12.4%	4.4%	3.5%	2.8%	3.6%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Despite a tumultuous history of government instability, economic stagnation, monetary instability, and hyperinflation, Bolivia has managed to turn itself around. It has been relatively stable and democratic since the mid-1980s—not coincidentally, the period when it overcame hyperinflation. Despite Bolivia's considerable political risks, it is likely to make steady but slow progress in reforming its economy and consolidating its democracy; since its decision latitude is limited by its need for foreign aid and financial support from multilateral agencies, it cannot deviate far from its reform path.

Although Bolivia has become politically stable, its economic fortunes are still tied to only a few activities, and its infrastructure remains very poor. The country derives most of its export revenue and income from energy and mining—gold, silver, zinc, tin, and oil and natural gas. The country is the world's second-largest producer of tin. Export revenues are highly dependent on world commodity prices, which are notoriously cyclical.

In recent years, privatization has been a major success. Following the passage of the innovative *capitalización* law in March 1994, the government targeted six state-owned enterprises—electricity, telecommunications, air transport, railways, mining and smelting, and hydrocarbons—and successfully privatized five of them.

President Banzer's latest economic program seeks to promote economic stability, as well as to reduce corruption during his five-year mandate. The president is attempting to achieve his goals of increasing Bolivia's annual GDP growth rate to 7% through a series of cuts in government spending, a reduction in the government debt, and an increase in investment. The president also plans to complete the capitalization program, survey the public about corruption, and monitor investment commitments made by private firms. The plan is likely to face strong opposition, though, given the high social costs of adjustment programs since the 1980s. The government is facing a rise in social unrest and a reduction of its credibility as a result of its decision to suspend a promised yearly payment to the elderly.

Since 1987, Bolivia's currency, the boliviano, has been relatively stable, depreciating in line with the country's inflation differential with the United States. An improvement in the country's macroeconomic fundamentals helped to prevent the violent fluctuations recurrent in the 1970s and early 1980s. The falling oil prices along with a strengthening of the economy continue to bring stability to the boliviano and preserve it under moderate risk.

Bolivia's GDP growth, which has averaged around 5% over the last seven years, could rise gradually to 8-9% by the end of the decade, when the results of privatization and reform become more evident. The government has revised GDP growth figures for 1998 to 4.8% due to the possible effects of El Niño weather patterns on economic activity. The major risks to stable economic growth are a departure from current economic policies on the part of the new government and a collapse in the prices of Bolivia's primary commodity exports.

In addition, economic growth might be affected by the Central Bank's over-riding focus on inflation reduction.

One risk to the economic forecasts is the possibility that Bolivia may face sanctions by the U.S. if it does not maintain its efforts in combating illegal drugs. The setbacks of some of Colombia's drug cartels have raised Bolivia's profile as a cocaine producer, making it more difficult for the country to meet U.S. anti-narcotic demands. The cultural tradition of growing coca plants among the country's native inhabitants is an obstacle to efforts to reduce the overall importance of coca as a source of income to local peasants.

Market Potential

Population growth in Bolivia has been extremely rapid, averaging over 2.7% since 1990. The growth rate is forecast to decline over the next twenty-three years, to reach a more reasonable 1.3% in 2020. Over the entire period, population growth will average 2.0%.

Two-thirds of Bolivia's population consists of indigenous groups, the most prevalent the Aymará and the Quechua. Despite their large numbers, indigenous ethnic groups are subjected to discrimination by the white and mestizo minority. This problem could become an increasing source of risk, since indigenous groups are becoming more assertive about their rights.

The structure of Bolivia's society prevents a large segment of the population from participating fully in an industrial economy. As a consequence, incomes in Bolivia are lower than all other Latin American countries except Haiti. Per capita GDP in 1997 was \$964 with market exchange rates. The small population and low incomes in Bolivia severely limit market potential. Despite rapid growth in per capita GDP, Bolivia's rank will remain near the bottom of Latin American countries.

Bolivia permits all goods to be imported freely, with the exception of goods controlled for public health or national security. A flat tariff of 10% applies to imported goods except capital goods, which face a 5% tariff.

Bolivia is a member of two Latin American trade associations. Within the LAIA, Bolivia has 'less developed' country status, which allows it to extend tariff concessions to only a limited list of commodities. Bolivia also has a special status under the Andean Pact, whereby it is allowed to keep its 10% tariff levels and still remain a part of the customs union. Recently, Bolivia became an associate member of Mercosur. Within ten years, tariff rates will be gradually reduced to zero on the majority of products. Bolivia is also a member of the WTO.

BRAZIL

- ▶ While economic stabilization has brought the economy under control and growing at just over 4%, it remains on uncertain foundations.

- Brazil represents one of the largest Latin American markets, with one-third of Latin American population and over 20% of all Latin American trade.

Exhibit II-7

Brazil	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	160.0	173.3	211.3	257.7	2.0%	33.6%	35.6%
Real GDP (95\$ bil.)	751.1	869.4	1346.1	1961.8	4.1%	42.4%	39.2%
Nominal GDP Per Capita (\$)	5,046	5,106	9,983	21,411	6.2%	--	--
Real Private Consumption (95\$ bil.)	495.3	559.5	810.4	1126.5	3.5%	--	--
Real Public Consumption (95\$ bil.)	123.2	138.5	208.6	312.6	4.0%	--	--
Real Fixed Investment (95\$ bil.)	170.2	228.1	394.3	657.3	5.8%	--	--
Nominal Exports (\$ bil.)	53.3	76.9	185.3	400.7	8.8%	20.7%	14.3%
Nominal Imports (\$ bil.)	67.0	98.4	252.0	577.4	9.4%	22.0%	18.1%
Exchange Rate (NCU/\$)	1.01	1.42	2.16	3.04	4.7%	--	--
Rate of Inflation	19.4%	8.3%	9.3%	10.8%	9.0%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

On most accounts, 1997 was an excellent year for the Brazilian economy. Price stability, real GDP growth in the 4-5% range, and political (and policy) stability had been elusive goals for Brazil since the early 1980s. During the past two years there has been a remarkable turnaround in business sentiment towards Brazil, which has translated into a surge in foreign direct investment. The question is now whether the success of the Real Plan can be maintained, and extended, to prevent a recurrence of Brazil's inflationary past and to help spur economic growth. There is still some considerable risk that the Plan might collapse; regarding the second issue, the current macroeconomic policy in Brazil limits growth without guaranteeing stability.

The way to reduce the economy's vulnerability and to enhance growth prospects is, according to the administration, to deepen structural reform. Some key steps in that direction have been taken since the Real Plan. Competition, for example, will increase as a result of greater trade openness, and by privatization and liberalization in such sectors as telecommunications, energy, and transportation. But a traditional source of macroeconomic imbalances has proven harder to deal with; fiscal reform has been dormant in congress for the past two years. Resistance to significant civil service and social security reform has been powerful, at times even within the ranks of the pro-government congressional forces.

An obvious source of potential problems is the overvaluation of the *real*, and its impact on the country's external accounts. Since the introduction of the *real* in 1994, the trade balance has gone from a surplus of over \$10 billion to a deficit of roughly the same magnitude in 1997. While these numbers are still low in terms of the traditional measures (share of GDP), the deteriorating trend has fed fears that in the medium-term Brazil would find itself in a position similar to pre-peso crisis Mexico.

The government response has been to use demand management to contain cyclical deterioration of the trade account, while addressing the exchange rate misalignment through a policy of gradual nominal devaluation of the *real*. The strategy has been moderately successful. It has achieved a small real devaluation of the exchange rate, while maintaining the monthly trade balance within expectations. The cost is output losses and potential employment pressures in coming years, as job growth is hurt by restructuring and an expensive currency.

The gravest danger is that even those sacrifices do not guarantee macroeconomic stability. The experience of the Southeast Asian economies suggests that even with the large volume of reserves at its command, Brazil's central bank may quickly be overpowered by a panicking market, if a sufficiently large shock occurs; a sharp devaluation of the currency might then ensue. Although it is now less certain that such devaluation would bring back the sort of macroeconomic chaos that took place before the Real Plan, the central bank would rather see the economy contract than take that risk. Hence, there is a high risk of an economic downturn.

At least in the next year the economy will be shielded by the appeal of the privatization process and the relative success of Southern Cone integration in Mercosur. Because of both reasons, at least 50% of 1997 and 1998's current account deficit will be financed with FDI inflows. Relatively benign conditions will also help Brazil finance a good portion of the rest with long-term debt (according to some estimates as much as 30% of the current account deficit). But in the medium term, unless the reform process is strengthened by Cardoso (or his successor), macroeconomic stability will remain on weak foundations. Based on current trends, real GDP is forecast to continue to grow at an average rate just over 4% into the next century.

Market Potential

Contrary to the experiences of other countries that have undergone stabilization processes in recent history, the employment picture has been surprisingly stable. The urban unemployment rate at the end of August, 1998 was 6.0%. Although the national rate hides significantly higher unemployment in the industrial heartland of Sao Paulo (in the neighborhood of 15%, according to Union surveys), even there the data suggest that unemployment has remained rather stable for the past 12 months. The stability of unemployment has combined with price stability to boost the political fortunes of President Cardoso. Household purchasing power has increased at the lower end of the income distribution, and financial stability has made it possible for a vast number of Brazilians to access consumer credit for the first time in many years.

With over a third of the population in Latin America, and relative good economic strength, Brazil represents the largest single market in Latin America. Real private and public consumption should grow over 3.5% per year, while business investment will grow even faster at 5.6%. Brazil ranks fifth in terms of nominal GDP per capita levels among Latin American entities.

Currently Brazil accounts for just over 20% of total Latin American trade. While the LATTs base line forecast calls for exports and imports to grow at a healthy 8.6% and 9.3% respectively, stronger growth in other Latin American countries will erode Brazil's total share of Latin American trade.

Brazil is a member of the Latin American Integration Association (LAIA), Mercosur, and the WTO. Reduced tariffs among Mercosur members have greatly increased trade between member nations, as firms take advantage of the specialization possible through the larger market. At the same, increased interdependence increases the risk of transmitting economic shocks beyond national boundaries.

Brazil's interests in continued economic integration was evidenced in a recent Rio Group meeting. At the time, Brazil submitted a formal proposal to develop a South America Free Trade Zone, spanning the entire South American continent. The free trade zone would involve eliminations of non-tariff barriers between Mercosur countries and other South American nations and scheduled reductions in tariffs within ten years.

CHILE

- ▶ Chile is forecast to have the highest GDP growth rate among Latin American countries, at 5.6% annually through 2020.
- ▶ Chile continues to expand trade liberalization, with associate membership in Mercosur and a trade agreement with Canada.

Exhibit II-8

Chile	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	14.5	15.4	17.8	20.7	1.5%	3.0%	2.9%
Real GDP (95\$ bil.)	71.7	91.8	160.4	265.2	5.6%	4.0%	5.3%
Nominal GDP Per Capita (\$)	5,072	6,729	14,056	33,566	8.2%	--	--
Real Private Consumption (95\$ bil.)	45.7	59.7	110.6	188.1	6.1%	--	--
Real Public Consumption (95\$ bil.)	5.9	6.6	9.2	13.9	3.6%	--	--
Real Fixed Investment (95\$ bil.)	17.8	25.3	44.3	75.7	6.2%	--	--
Nominal Exports (\$ bil.)	19.8	27.9	74.3	171.9	9.4%	7.7%	6.1%
Nominal Imports (\$ bil.)	20.8	27.5	74.1	193.6	9.7%	8.1%	6.9%
Exchange Rate (NCU/\$)	412.6	466.8	529.1	551.1	1.2%	--	--
Rate of Inflation	7.4%	3.5%	4.7%	6.0%	4.6%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

By achieving annual GDP growth of 7% over the past decade, Chile has rightfully gained the reputation for having the strongest and steadiest economy in Latin America. Sound fiscal and monetary policy, a transparent regulatory environment, and vast mineral reserves are the foundations for an attractive

investment environment. Despite occasional tensions between its military and civilian establishments, Chile has one of the most stable democracies in Latin America. The combination of sound economic policy and political stability will ensure that the Chilean economy will remain the region's most dynamic over the near term.

One of the most conspicuous aspects of Chile's economic strengths is the lack of conspicuous problems. Unlike many of its neighbors, Chile's current-account deficit is minimal, productivity is increasing, and the average real wage is increasing. These favorable trends give the Chilean government the flexibility to maintain its prudent economic policies as the economy thrives.

Low levels of government debt and a history of on-time repayment give the Chilean government and businesses relatively easy access to capital. Chile boasts the best Latin American Standard & Poor's foreign currency debt rating (A-). Inflation control and a fairly stable real exchange rate add to growth prospects. Recent interest rate cuts will soon stimulate investment, boosting both industrial production and employment. Mineral extraction, particularly copper, will remain the key area of development. While agriculture, forestry, and fishing will account for much of the rest of economic activity, manufacturing will continue to grow. Manufacturing has increased its share of total exports from 6% to 18% over the past decade. Chilean firms have begun to export cars, for example, and look forward to penetrating the Mexican consumer market soon.

Despite substantial diversification, primary commodities continue to account for the bulk of economic activity and exports. A sustained fall in commodity prices would have significant repercussions. The baseline forecast assumes weaker copper prices, but not a collapse that would drastically reduce export revenues.

Over the next 23 years, real GDP is forecast to grow at a rate of 5.6%, giving Chile the distinction of the highest growth forecast among the Latin American entities.

Market Potential

Chile also has one of the highest GDP per capita levels in Latin America. Although the country has a smaller population, approaching 15 million, consumptive capacity among that market is quite high. Real private consumption in Chile is forecast to grow at 6.1%, the highest rate among the largest countries in Latin America. GDP per capita growth is also the fastest in the region, sprinting ahead at an average pace of 8.2% per year, well above the average rate of inflation.

The government's continued pursuit of free trade will spur economic growth. Chile became an associate member of Mercosur in September 1996 and entered an initial bilateral trade agreement with Canada in 1997. Incorporation into NAFTA has been delayed by the failure of the 1998-2000 effort to obtain fast-track negotiating powers.

Chile's associate status in Mercosur has allowed it to join its free trade zone without adopting the common external tariff system. Beginning in the fall of 1996, tariffs on goods not subject to exceptions were reduced by 40%, with further reductions to proceed progressively over eight years until 2004. Tariffs for sensitive goods will be liberalized in 10 to 15 years. Chile has opted to exempt its wheat and wheat products market for 18 years. In compensation, Chile has allowed deeper penetration into its beef and rice markets, and has opened its dairy market to products from Mercosur.

Trade between Chile and Mercosur members falls under similar rules of origin as other members. Under the terms of the agreements, 60% of components of the goods must be of national origin, while 40% may originate from outside Mercosur.

COLOMBIA

- ▶ Colombia ranks second in real GDP growth in Latin America, averaging 5.3% through 1997-2020.
- ▶ Membership in several trade agreements will support trade growth of 8.5% through the forecast period.

Exhibit II-9

Colombia	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	35.7	38.1	44.4	51.5	1.5%	7.5%	7.1%
Real GDP (95\$ bil.)	81.0	94.2	154.5	273.4	5.2%	4.6%	5.5%
Nominal GDP Per Capita (\$)	2,372	2,978	5,920	8,978	5.7%	--	--
Real Private Consumption (95\$ bil.)	55.2	62.0	89.1	134.6	3.8%	--	--
Real Public Consumption (95\$ bil.)	10.4	12.3	18.6	28.0	4.2%	--	--
Real Fixed Investment (95\$ bil.)	16.5	20.6	39.9	81.5	6.9%	--	--
Nominal Exports (\$ bil.)	13.5	19.1	42.7	95.9	8.5%	5.3%	3.4%
Nominal Imports (\$ bil.)	17.0	24.1	54.8	119.8	8.5%	5.6%	3.8%
Exchange Rate (NCU/\$)	1,037	1,777	4,445	10,218	10.0%	--	--
Rate of Inflation	20.6%	18.4%	11.4%	7.0%	11.7%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

After 30 years of consistent year-on-year growth, the Colombian economy has slowed significantly. Real GDP growth fell to just 2.1% in 1996, a sharp drop from its 5.3% pace in 1995. Two factors contributing to this slowdown were the political unrest stemming from the President Samper controversy and the costs of Colombia's efforts to combat the drug trade. Political troubles have severely affected gross domestic investment. Although political pressure remains on President Samper, the crisis peaked in 1996. GDP growth will likely increase after 1997 to average 5.3% again in the forecast interval 1997-2020.

The fiscal cost of the war against drugs has been large, contributing to a deficit in the government accounts that in 1996 reached an estimated 4.5% of GDP. With the disruption of the major known drug cartels in recent years, some recent legal activities tied to cartel finances have suffered, damaging sectors of the economy such as the construction sector in the Cali area.

One risk to the economic forecast is increased political instability. The controversy surrounding Samper's administration has mostly subsided for the remainder of his term and it is expected that the next president will be better received by the United States and foreign investors. Although violence will still be a problem in Colombia, it is likely that the U.S. government will take the opportunity of a new Colombian administration to restore U.S.-Colombia relations to a healthier level of cooperation in matters of mutual interest. This likely turn of events makes U.S. drug-related sanctions even less probable, and will likely boost business confidence and investment. However, if political instability continues, it could lead to a decline in foreign direct investment. British Petroleum, for example, has recently indicated that it will relocate its South American headquarters to Venezuela. Should others follow, the attractiveness of Colombia even for high-yield investments would likely diminish.

Market Potential

With a population of 36.3 million in 1997, Colombia represents the third largest market in Latin America in terms of consumer size. However, a relatively low GDP per capita and slow growth in average incomes diminishes the market potential.

Real consumption rates will experience mild growth, mostly as a result of faster growth in private consumption, which will increase from 2.1% in 1997 to an estimated 3.2% in 1998. Growth in private consumption is expected to continue to increase, averaging 3.9% through 2020, while public consumption growth will remain reasonably steady at 4.2%. CPI inflation will rise slightly to 19.1% this year, but is forecast to then decline steadily thereafter, to reach 7.0% by 2020. Moderating forces on price increases are relatively weak domestic demand and the relative stability of the exchange rate, which will depreciate roughly 15% on average. Demand for industrial goods should continue to increase, as real fixed investment demand grows at an increasing rate, averaging 7.0% growth over the next 23 years.

The export sector has under performed significantly in recent years. Nominal export growth fell to 2.4% in 1996 despite high oil prices and increased oil production. In fact, a side effect of the strong oil sector has been a strong—and during part of 1996—an appreciating peso. This occurred as a result of both high oil prices and increased investment in the industry.

Exports will recover to a growth rate of 9.0% in 1998 despite the continued real appreciation of the peso. The recovery from the non-oil sectors of the economy will come at a good time, now that oil prices have declined from their 1996 highs. Investment in the oil sector will nonetheless remain important, with volumes

increasing considerably in coming years. Through 1997-2020, both exports and imports are forecast to grow at a healthy average pace of 8.5%.

Colombia's position on the northern section of South America is a strategic location to take advantage of trade linkages both to the north and the south. As a result, Colombia is a member of the Andean Pact, the LAIA, and the Group of Three free trade agreement between Colombia, Mexico, and Venezuela. It also has an agreement with CARICOM.

CUBA

- ▶ Cuba is recovering from the deep recession induced by the loss of Soviet aid. Annual economic growth of 2.3% is expected over 1997-2020.
- ▶ Tourism has become the most important sector in Cuba.
- ▶ Exports are forecast to grow strongly as economic reform eases trading practices.

Exhibit II-10

Cuba	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	11.0	11.2	11.9	12.5	0.5%	2.3%	1.7%
Real GDP (95\$ bil.)	20.7	21.1	30.0	37.4	2.5%	1.2%	0.7%
Nominal GDP Per Capita (\$)	1,931	2,069	3,574	6,020	4.9%	--	--
Nominal Exports (\$ bil.)	1.87	2.67	7.66	19.29	10.2%	0.7%	0.7%
Nominal Imports (\$ bil.)	2.23	3.06	8.16	19.65	9.5%	0.7%	0.6%
Exchange Rate (NCU/\$)	1.00	1.30	1.75	2.42	3.7%	--	--
Rate of Inflation	6.7%	5.7%	6.0%	5.9%	5.9%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Political Factors

Cuba's economic and risk outlook remains unfavorable due to the rigidity of its Communist government.

The premeditated shooting down of a private aircraft owned by the Hermanos al rescate exile group in 1996 has prolonged and intensified the U.S. embargo against Cuba and deterred some foreign investment. The United States certainly has the capability to inflict far more damage to Cuba's economy than its existing sanctions, and Castro has demonstrated a brazen tendency to provoke the United States. Nevertheless, the probability of far more severe sanctions is not high. Under current conditions, a dramatic change in the U.S. policy is unlikely.

Developments over the last 20 months indicate that most foreign investors with major investments in Cuba are ignoring the threats of U.S. sanctions under the Helms-Burton Act, while those with small stakes have pulled out or at least will

refrain from further investments. A number of firms with major investments in the United States have already divested their interests in Cuba rather than face U.S. sanctions, but in most cases, there are foreign investors willing to step in and fill their places.

Internal Problems

There have been some signs of increased internal social tensions as a result of the growing gap between emerging private-sector entrepreneurs and other Cubans, who in many cases resent their lower incomes. While gradual economic liberalization will likely continue, the government's periodic slogans on "ideological firmness" and statements that it will allow only economic reforms that are supportive of "the objectives of socialist society" could deter private investment and reduce the economy's potential.

Until the 1980s, crime was not a major problem in Cuba. Since the collapse of the Soviet Union and the loss of Russian aid, however, crime has been rising at an alarming rate, although reliable statistics are hard to come by. The government blames the rise on "decadent capitalist" influences, and has launched a number of campaigns to counter it through both additional security efforts and restraint of capitalism. The increasing crime rate is driven by the large number of young people in the population and the decreasing legitimacy and influence of the Communist Party's security and social institutions. Nevertheless, the impact of crime on foreign business is not yet very high, because in most cases such enterprises are located in isolated enclaves and are much better protected by the state security forces than local businesses. This will change, however, as the role of foreign business in the Cuban economy expands and the enterprises can no longer be easily isolated from the local population.

Economic Outlook

After contracting by as much as 45% during 1989-93 due to Soviet aid cuts, Cuba's economy expanded more strongly in recent years due to a rebound in exports and an expansion of tourism. An extremely tight monetary and fiscal policy since the Soviet collapse in 1991 has managed to drastically cut Cuba's fiscal and external debt to manageable levels. During the second half of 1996, the government increased liquidity and provided more goods in government-run local currency stores. These actions reflect an easing of monetary and fiscal policy designed to relieve the population's hardship after nearly seven years of sacrifice. As the economic recovery continues, austerity will be eased further.

Cuba has been hesitantly encouraging the country's embryonic private sector by slowly adopting more liberalized economic policies, particularly in urban services and small-scale farming. Foreign investors can now hold 100% stakes in companies, and 170,000 Cubans (about 5% of the labor force) have been permitted to become self-employed. The emphasis, however, has been mainly on facilitating large-scale foreign investment in foreign tourism enclaves, which are largely insulated from the Cuban society. The country now accepts the U.S. dollar as a legitimate form of exchange, but heavily taxes dollar incomes both

directly and through excessive charges for licenses and using government facilities.

Tourism has been a stronger mainstay of the economy than sugar exports; about one million tourists visited Cuba in 1996, and this number climbed by 20% in 1997. Tourism earnings were \$1.3 billion in 1996 and \$1.5 billion last year, far surpassing the sugar industry's export earnings. Cuba's tropical location and scenic beauty give it a huge potential for further tourism development, but it will not be fully realized as long as U.S. economic sanctions remain. Furthermore, despite success in getting short-term credit and some debt relief, Cuba continues to suffer from a shortage of medium- and long-term credit. Reliance on short-term, high-interest credit is a major obstacle to more rapid economic progress. The U.S.'s long-standing policy of opposing Cuban membership in multilateral institutions such as the IMF and World Bank further handicaps access to funds.

Cuba's balance of payments situation will gradually improve because of increasing trade and investment flows from Europe, Canada, and Latin America. Cuba's official exchange rate for the peso remains fixed at one peso per U.S. dollar. For most personal transactions, however, there is a more realistic parallel market rate that has been 20-22 peso/dollar in recent years. The risk of a major depreciation is high because of the volatility of the parallel rate and a high likelihood that Cuba will eliminate its overvalued official fixed rate within the next five years.

In the absence of a military blockade, the Cuban economy will continue its gradual recovery in the longer term. Average real GDP growth of 2.3% is expected over the next 23 years. The risk of a recession is low as long as there is no major retrenchment in economic reform or a major collapse in sugar prices. The economic stabilization policy, with gradually easing monetary and fiscal policy, will likely continue as long as Fidel Castro is in power. After he is gone, the likelihood of a more radical policy change—such as rapid economic liberalization—will increase, as will the risk of economic instability, since a power vacuum will be highly likely.

Market Potential

Per capita income in Cuba is below the average for Latin American countries, but higher than several of its Caribbean and Central American neighbors. Real GDP per capita is forecast to grow at 4.7% over the forecast period.

Cuba's merchandise export revenue is dominated by sugar, which will have an output of only 3.5 million tons in 1997-98, compared with 4.25 million tons in 1996-97. As in the past, the government intends to overcome the setbacks in 1998-99 by exhorting sugarcane workers to heroic efforts. Such appeals stopped being effective many years ago, however, and are highly unlikely to work this time either.

The trade market, however, is expected to grow faster, as economic reform eases trading practices. Current expectations are that exports will increase at an annual average rate of 10.0%, and imports at 9.3% over the next two decades.

Due to its political isolation, Cuba is not included in any of the several economic and trade agreements in the region. Cuba has been prevented from even joining international institutions such as the IMF and the World Bank. However, Cuba is an observer to LAIA and a member of the WTO.

DOMINICAN REPUBLIC

- ▶ Real GDP growth will average only 2.1% annually through 2020.
- ▶ Extremely low incomes and a nominal GDP per capita growth that lags inflation limit consumer market potential.

Exhibit II-11

Dominican Republic	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	7.7	8.3	9.6	11.1	1.5%	1.6%	1.5%
Real GDP (95\$ bil.)	11.0	12.0	14.7	18.0	2.1%	0.6%	0.4%
Nominal GDP Per Capita (\$)	1,456	1,598	2,155	3,257	3.4%	--	--
Nominal Exports (\$ bil.)	4.9	7.9	19.8	44.3	9.6%	1.9%	1.6%
Nominal Imports (\$ bil.)	5.4	7.7	18.9	40.2	8.7%	1.8%	1.3%

Economic Overview

The Dominican Republic occupies two-third of the island of Hispanola in the Caribbean. The Dominican Republic began economic reforms in the mid-1990s, which stabilized the exchange rate, reduced inflation, and contributed to strong GDP growth. However, a large external debt, bankrupt state enterprises, and a troubled manufacturing sector have prompted the government to further economic reforms to increase the competitiveness and market-orientation of the economy. The currency was devalued, income taxes were cut, sales taxes were increased by 50%, and import tariffs were reduced. Investment to the economy increased after a new law in 1996 permitted repatriation of capital dividends.

Agriculture remains a dominant sector in the economy, accounting for 13% of GDP in 1995 and nearly half the labor force. Services account for 55% of GDP and, combined with government, employ 32% of the labor force.

Without a strong sector stimulating the economy, real GDP is forecast to grow at a slow pace. The growth rate will average 2.1% annually over the next 23 years, with growth slowing after five years to a steady rate.

Market Potential

The Dominican Republic is one of the poorest countries in Latin America, with a nominal GDP per capita of \$1,493 in 1997. Relatively slow growth of 3.5% over the forecast period will limit the potential of a consumer market in the Dominican Republic. In fact, the Dominican Republic will see its rank in GDP per capita fall from 15th place in 1997 to 17th in 2020, as Bolivia and Ecuador overtake it due to much faster growth in average incomes.

Trade is an important component of the Dominican economy, with the U.S. being the dominant partner. In 1995, 82% of Dominican exports and 66% of its imports were bound for the U.S. The European Union is the second largest partner for Dominican trade. Nominal exports and imports are forecast to continue to grow quickly over the forecast period, rising at a rate of 9.3% and 8.6%, respectively.

The Dominican Republic is a member of the Caribbean Basin Initiative and the WTO. As well, the Dominican Republic is an observer in CARICOM and the LAIA.

ECUADOR

- ▶ Economic concentration in natural resources and political instability limits growth to 3.9% through 2020.
- ▶ With slow nominal GDP per capita growth and high inflation, GDP per capita levels will remain low.

Exhibit II-12

Ecuador	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	11.7	12.8	15.8	19.2	2.1%	2.5%	2.6%
Real GDP (95\$ bil.)	18.5	21.9	32.4	46.4	3.9%	1.0%	0.9%
Nominal GDP Per Capita (\$)	1,398	1,593	2,351	3,601	4.0%	--	--
Real Private Consumption (95\$ bil.)	12.5	15.0	22.5	33.0	4.1%	--	--
Real Public Consumption (95\$ bil.)	2.4	2.6	4.1	6.1	4.0%	--	--
Real Fixed Investment (95\$ bil.)	3.5	4.0	6.3	9.6	4.3%	--	--
Nominal Exports (\$ bil.)	5.6	6.4	13.3	29.2	7.1%	2.2%	1.0%
Nominal Imports (\$ bil.)	5.3	6.0	13.6	30.6	7.6%	1.7%	1.0%
Exchange Rate (NCU/\$)	3,189	7,545	33,139	119,115	16.3%	--	--
Rate of Inflation	24.4%	23.7%	17.8%	16.4%	18.5%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Ecuador's strengths are oil, agriculture, and fishing; while low productivity, insufficient education, and poor infrastructure hold back the country from stronger growth. On the other hand, Ecuador has maintained a stable economic environment, avoiding the sharp economic swings experienced over the past ten years by Latin America's largest economies.

Political instability has aggravated Ecuador's economic problems over the past year. The economic repercussions have not been disastrous, but they have hurt Ecuador's prospects. The government deficit has widened. Domestic subsidies for electricity and public transportation remain high, while tax evasion is rampant. Inflation has increased and growth in fixed investment is waning.

Inflation will remain in double digits, but be stable, while the peso continues to depreciate in line with consumer prices, hence keeping the real exchange rate fairly steady. With the domestic economy gaining some momentum, the current account deficit will worsen. Rising domestic demand will raise imports more rapidly than exports can potentially grow. Currency instability across Asia plus concerns in Latin America will deter any dramatic inflows of capital. Hence, the Ecuadorian government will work hard to keep its external balances within reasonable shape.

The exploitation of natural resources will remain the country's key driver of economic growth. Ecuador is the world's largest exporter of bananas and is slowly increasing its oil production. After years of neglect, the government is working toward improving the capacity of oil pipelines. Tourism—particularly to the Galápagos Islands—also draws revenues. The focus on natural resources, however, keeps Ecuador from developing into a wealthier nation. The lack of diversification leaves the national economy susceptible to sharp swings in commodity prices, as well as adverse weather patterns.

Growth will rebound in the next few years. In large part, this is simply due to the current point of Ecuador's business cycle: the inventory draw-down over the past two years has led to a need for greater production. This, along with strength in the country's oil and agricultural sectors, will help the economy return to 4%-plus annual growth over the next few years. Slowing growth rates after 2000 will hold average annual GDP growth down to 3.9% through 2020.

Market Potential

Ecuador is one of the poorer nations in South America, with annual nominal per capita income of less than \$1,500. Ecuador's small population and low GDP per capita limit the market potential. Strong population growth and relatively slow GDP growth will hold down GDP per capita growth to 4.0% over the next 23 years. However, continued high inflation rates will erode any improvements in real income.

Ecuador is a member of the LAIA, the Andean Pact, and the WTO, and has a trade agreement with Chile.

FRENCH GUIANA / GUYANA / SURINAME

- ▶ These three countries, dependent on agriculture and mining, will experience relatively slow economic growth over the LATTTS forecast period.
- ▶ Evidence of French Guiana's French department status is seen in its high GDP per capita, while its neighbors are among the poorest in the region.

Exhibit II-13

French Guiana/Guyana/Suriname	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	1.41	1.47	1.62	1.78	1.0%	0.3%	0.2%
Real GDP (95\$ bil.)	4.63	5.25	6.92	8.27	2.4%	0.3%	0.2%
Nominal GDP Per Capita (\$)	3,373	3,948	6,041	9,328	4.3%	--	--
Nominal Exports (\$ bil.)	1.56	1.84	2.97	4.95	4.9%	0.6%	0.2%
Nominal Imports (\$ bil.)	5.49	7.86	18.23	39.11	8.5%	1.8%	1.2%

Economic Overview

French Guiana is in fact a department of France, and is administered by that government. The economy of this region is closely tied to the French economy through subsidies and imports. Its primary industries are fishing and forestry. A French space center is also an important component of the local economy.

Guyana, one of the poorest countries in the Western Hemisphere, has experienced steady, strong economic growth in recent years. Modest inflation and a more realistic exchange rate, as well as expansion in agricultural and mining sectors have all contributed to growth. Infrastructure problems and a large external debt continue to influence future expansion.

After dismal economic conditions only a few years ago, Suriname has regained positive trends. The government's move to economic reforms, including a unified exchange rate and tight monetary policy, have conquered inflation and eased the budget deficit. They also initiated the release of substantial development aid from the Netherlands, which was held up pending economic reforms. The Surinamese economy is vulnerable to movements in the bauxite industry, which accounts for more than 15% of GDP and 65% of export revenue.

Combined, real GDP for this region was \$4.9 billion in 1997, edging out the more populous Haiti for the second lowest level in Latin America. However, three-quarters of the GDP for this region are earned by tiny French Guiana, which also has the lowest population. The average growth rate for the three countries is forecast at 2.3% over the next 23 years.

Market Potential

These three countries, even combined, have the smallest population of all the Latin American entities considered here. Neither will population growth be

relatively fast in the future, increasing at an average rate of only 1.0% over the next 23 years. Out-migration is the main reason for slow population growth.

While this cluster's average nominal GDP per capita ranks 8th among Latin America entities, this conceals large discrepancies among the three countries. French Guiana had a nominal GDP per capita of \$24,639 in 1997, while Suriname had only \$1,207 and Guyana just \$902.

Exports of fish and fish products—mostly shrimp—account for over half of French Guiana's revenue. It is equally dependent on imports of food and energy. Trade is primarily with France: 71% of exports and 64% of imports in 1995.

Guyana's exports are primarily agricultural and mineral; key products are sugar, gold, bauxite, rice, and shrimp. The U.S. became the leading destination in 1995, edging out Canada for the largest share of Guyanan exports. Together, the U.S. and U.K. account for half of Guyanan imports, which tend to be manufactured goods, energy, and food. Guyana also imports substantial amounts from its Caribbean neighbors, principally Trinidad & Tobago.

As mentioned, the majority of exports from Suriname are alumina or products from the bauxite industry. The remainder are agricultural products. Export markets are more diversified than Suriname's neighbors, with the largest single destination the EU. Food, petroleum, and capital equipment are imported into Suriname. Venezuela accounted for almost half of imports in 1995.

While Guyana and Suriname account for the majority of exports in the combined region, French Guiana comprise nearly three-quarters of imports in the region. As almost all exports from these regions are commodities subject to economic fluctuations, modest growth in exports is forecast. Growth in nominal exports will average 4.9% annually. Imports will continue to grow strongly at 8.5% per year over the next two decades.

Guyana and Suriname are both members of CARICOM. Guyana is also a part of CARIBCAN and the CBI. Both are members of WTO.

HAITI

- ▶ Extreme poverty, lack of economic reforms, and political quagmires hold growth to an average 1.3% over the forecast period.
- ▶ Haiti is dependent on imports of food and manufactures, two-thirds of which come from the U.S.

Exhibit II-14

Haiti	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	6.6	7.0	8.3	9.6	1.6%	1.4%	1.3%
Real GDP (95\$ bil.)	2.1	2.1	2.6	3.0	1.5%	0.1%	0.1%
Nominal GDP Per Capita (\$)	327	331	448	623	2.7%	--	--
Nominal Exports (\$ bil.)	0.22	0.23	0.36	0.59	4.2%	0.1%	0.0%
Nominal Imports (\$ bil.)	0.97	1.16	2.19	3.65	5.7%	0.3%	0.1%

Economic Overview

Haiti is among the poorest countries in the world. About 75% of the population live in abject poverty. Roughly two-thirds of Haitian employment is in agriculture, primarily in small-scale subsistence farming. A 1996 estimate placed the unemployment rate at 60%—almost no jobs have been created since President Preval took office in February 1996. Haiti's inability to come to agreement with international sponsors has prevented its access to much needed development assistance.

Haiti's sporadic economic development has led to negative growth forecasts through 2000. By then the economy is expected to reshape itself for positive growth in subsequent years. Over the LATTTS forecast period, real GDP growth is forecast to average 1.3% annually.

Market Potential

The extreme poverty of Haiti is evident in its nominal GDP per capita of \$343 in 1997. Relatively robust population growth and slow economic growth will combine for slow growth in average income. An average annual growth rate of 2.6% will not succeed in doubling average nominal income by 2020.

Imports are an important component of the Haitian economy. Food and food products account for nearly a quarter of imports, while machines and manufactures and petroleum products are other dominant sectors. Exports are made up of coffee and light manufactures—primarily textiles and apparel. Two-thirds of Haitian trade is with the U.S.

Haiti is a member of the Caribbean Basin Initiative and the WTO, as well as an observer in CARICOM.

MEXICO

- ▶ Mexico is almost completely recovered from the peso crisis in 1994, and economic and political practices position it for stable, sustainable growth in the future.
- ▶ Mexico's membership in key trade agreements and rapid growth in trade will propel it to account for almost half of all trade in Latin America by 2020, more than double its share of population or real GDP.

Exhibit II-15

Mexico	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	90.7	97.5	113.8	130.8	1.5%	19.0%	18.1%
Real GDP (95\$ bil.)	258.9	323.2	502.8	733.7	4.4%	14.6%	14.7%
Nominal GDP Per Capita (\$)	3,166	5,089	10,754	20,963	8.2%	--	--
Real Private Consumption (95\$ bil.)	172.5	209.6	324.7	503.2	4.6%	--	--
Real Public Consumption (95\$ bil.)	29.9	35.0	50.7	73.7	3.8%	--	--
Real Fixed Investment (95\$ bil.)	51.1	87.6	150.0	227.9	6.4%	--	--
Nominal Exports (\$ bil.)	79.0	151.3	523.7	1520.7	13.1%	30.8%	54.4%
Nominal Imports (\$ bil.)	72.8	153.4	486.2	1412.2	13.2%	23.9%	44.3%
Exchange Rate (NCU/\$)	7.6	9.7	13.3	16.8	3.3%	--	--
Rate of Inflation	34.4%	11.3%	7.6%	7.5%	8.3%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

National accounts data confirm that the recovery of the Mexican economy is gathering momentum. Real GDP grew faster than 7% in 1997. Thus far, the recovery has been export- and investment-driven: nominal exports grew 27% last year, while real investment expanded 22% during the same period.

Mexico stands out among most major emerging markets as the world economy faces the consequences of the Asian crisis. The problems in Asia have led to a generalized retrenchment of international investors from emerging financial markets. This has led to asset deflation in markets from Thailand to Brazil. However, the strength of Mexican fundamentals makes the Mexican market a prime candidate to benefit from a potentially significant redistribution of international investment portfolios in the next few months. Even in the absence of such reallocation, though, privatization, foreign direct investment, and portfolio investment will suffice to finance the demands of the resurging Mexican economy in the near term.

In the short run, the Asian crisis does marginally increase the potential for significantly slower growth. But unlike Asian and other Latin American economies, where such potential comes from the direct impact of the crisis on investment and consumption, in Mexico's case the impact of the Asian crisis is indirect. The key link, in fact, is through the impact of the Asian devaluations and subsequent slowdowns on the U.S. economy, which will most likely be modest, reducing U.S. real GDP growth from a previously anticipated 2.5% in 1998 to 2.0%. Indeed, the expectation of lower economic growth will have the side benefit of preventing a rise in U.S. interest rates at least through the second half of 1998, when there is actually some probability that those rates should fall to maintain growth near its potential rate.

Positive economic signs in Mexico at the beginning of 1998 are external accounts that are roughly in balance, clear advances in political reform, and—critically—a rather prudent macroeconomic policy that has broad support across political lines. Given the improvement of medium-term risk and the opportunities offered by NAFTA, Mexico has the potential to enter a phase of accelerated,

sustained growth. Real GDP is expected to continue to grow at a rate of 4.3% over the long term.

Market Potential

Mexican (nominal) GDP per capita is above the Latin American average, and is forecast to grow at one of the fastest rates in the region, at 7.8% per year. With a population of over 90 million in 1997 and a population growth rate of 1.5% per year, the Mexican market is a key target in Latin America. Indeed, it accounts for 19% of the Latin American market and 15% of regional GDP.

Real consumption had been a relative laggard in Mexico's economic recovery, growing only marginally from the very depressed levels it reached in 1995. This has been changing in the last few months, however. After growing only 2% year-on-year during the first quarter of 1997, real private consumption growth accelerated to 6.9% and 7.8% in the second and third quarters, respectively, for a total annual increase of 6.3% in 1997. This was insufficient for a complete rebound, however; real consumption levels in 1997 were still below those of 1994, before the peso crisis erupted. Nevertheless, real private consumption will likely continue to grow at an annual average rate of 4.5%, closing the gap by 1998.

Part of the reason for the rebound in private consumption is the rapid decline of unemployment. The unemployment rate has dropped to levels near those that prevailed prior to the peso crisis, thanks to very fast growth in the industrial sector. The rate of unemployment and partial employment, which includes those unable to work more than 15 hours a week, has dropped significantly, to around 7.9% in November 1997.

The pick-up in consumption is essential for the sustainability of the ongoing economic expansion, since other sources of growth will likely play a lesser role in 1998. Exports will still grow at a respectable rate, but stronger competition from Asia and a weaker U.S. economy will almost certainly translate into a slower pace of sales abroad. Investment will also continue to grow strongly, but it will decelerate as well compared to 1997. Although real investment is finally reaching pre-crisis levels, it will likely be dampened somewhat by slower export growth, slow growth in commercial lending, and reduced international liquidity.

Mexican trade, as a share of Latin American trade, surpasses its population share in Latin America. Mexican trade accounts for over a third of Latin American exports and nearly as much imports. Average growth of over 12% per year is forecast for nominal exports. Exports have grown very rapidly since Mexico's entrance into NAFTA, as did imports before the peso crisis. Import growth, however, has recovered, and will combine with exports to account for almost half of all trade in Latin America in 2020.

Mexico's links with both North America and Latin America are reflected in its trade associations. Mexico's entrance into the North American Free Trade Agreement in 1992 was a much anticipated and debated event, linking an emerging market with two of the strongest economies in the world. As duties

between the three NAFTA countries continue to fall, a significant redistribution of industrial location is taking place between the countries.

International linkages have also been forged south of Mexico's border. Mexico is a member of the Latin American Integration Association, and is a founding member of the recently formed Group of Three, which includes Colombia and Venezuela. As well, Mercosur is a member of the WTO and an observer in CARICOM.

PANAMA

- ▶ Panama ranks fifth in economic growth among Latin American entities, with an average annual growth rate of 5.0%; however, this may be threatened by increasing political risks in the short term.
- ▶ Panama has positioned itself as a key re-exporter of manufactured goods, pushing up nominal export growth to a leading rate of 12.6% per year.

Exhibit II-16

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the

Panama	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	2.7	2.9	3.3	3.7	1.3%	0.6%	0.5%
Real GDP (95\$ bil.)	7.8	9.3	15.2	24.6	4.9%	0.4%	0.5%
Nominal GDP Per Capita (\$)	2,970	3,590	6,498	13,419	6.5%	--	--
Nominal Exports (\$ bil.)	1.32	2.20	7.23	22.73	12.6%	0.5%	0.8%
Nominal Imports (\$ bil.)	15.64	20.73	44.96	99.85	8.0%	5.1%	3.1%
Exchange Rate (NCU/\$)	1.0	1.0	1.0	1.0	0.0%	--	--
Rate of Inflation	1.3%	1.9%	2.5%	2.5%	2.3%	--	--

average rate of inflation in 1997-2020.

Economic Overview

However, there are several political risks that could endanger Panama's outlook. Investor confidence in the country's political stability could decline when the United States withdraws its military forces in 1999. At the same time, increasing political polarization over the issue of extending the U.S. military presence could undermine the government's popularity and result in legislative deadlock. With elections planned for 1999, the government is becoming increasingly more partisan-like and the opposition parties are looking for allies to oppose the ruling PRD. The ruling party's desire to extend the presidential term is likely to generate intense resistance among other political parties.

Panama could also face sanctions from the United States if it continues to allow international smugglers to use its territory and businesses with impunity for narcotic trafficking and money laundering operations. Panama suffers from a high level of corruption and crime, aggravated by the presence of many narco-traffickers in the country. The increase in violent and property crime could deter

foreign investment and tourism. Indeed, the problem is already a major obstacle to the recovery of Panama's financial and tourism industries.

As long as U.S. troops remain in Panama, the country's political risk is considered to be minimal. After 1999, political risk will depend on the extent of U.S. presence, if any. In spite of nationalist pressure on the Balladares administration, the United States might remain in at least Howard Air Base, but it is highly uncertain in what capacity.

Currently, the Panamanian economy is recuperating from slow growth in the last couple of years. The economy is expected to expand by 4.7% this year, compared with 4.0% in 1997 and 1.6% in 1996. Inflation was reduced to 1.2%, and unemployment decreased to 13%. While most of the expansion occurred in the mining sector, which grew by more than 17%, other sectors like trade and fishery reported increases of around 15% and 14%, respectively. Over the next 23 years, growth should average 5.0%, as foreign investment picks up and the military bases evacuated by U.S. troops attract developers.

Panama's open economy, close ties to the United States, and prudent economic policies are key factors in healthy growth forecasts. Since General Noriega's removal and the abolition of the national army in 1989, the country has benefited economically from the presence of U.S. troops, which has helped to rebuild investor confidence in the country's political stability and economic viability. The government of President Ernesto Balladares has implemented sound policies that have stabilized the economy and attracted foreign investment. By avoiding political partisanship over economic policy, President Balladares has overcome the problems of legislative deadlock and policy paralysis faced by his predecessor.

Market Potential

Panama is a small country and had a population of just 2.7 million in 1997. Incomes in Panama are quite low compared to western standards, but are the highest of the Central American and Caribbean countries surveyed here. Real GDP per capita is forecast to grow at a rate of 6.6% over the forecast period, bringing the mean income in Panama above the average for Latin America.

Potential tension between two of Panama's larger trading partners—Hong Kong and Taiwan—may impact the country's investment and export outlook. While Panama is Hong Kong's main port of entrance into Latin America (approximately 35% of the exports into the region pass through Panama), Taiwan has been steadily increasing its investments in the country. Tensions between the two countries could cause a decrease in the use of Panama's ports, and a consequent decrease in Panamanian exports.

Panama's non-manufacturing merchandise exports, which consist primarily of commodities—particularly bananas and coffee—are vulnerable to price volatility. The country's manufacturing exports are largely re-exports from the country's Colón Free Trade Zone. Higher export incentives and lower export taxes have been increasing the country's re-exports. In addition, the privatization of the

country's ports last year cut servicing costs by about one-half, increasing the port's international appeal.

Due to the increasing potential for re-exports, Panama has the highest growth rate in exports in the Latin American countries examined here. Similar to trade growth in recent years, exports are forecast to grow at an average annual rate of 12.6%, while imports will increase by 8.1% annually throughout the forecast period.

Panama is a member of the Caribbean Basin Initiative. The CBI, which covers both Caribbean and Central American countries, allows tariff-free imports of classified merchandise into the U.S. from member countries. At least 35% of the value of goods must be attributable to one or more beneficiary countries. As well, Panama is an observer in the LAIA and a member of the WTO.

PARAGUAY

- ▶ Economic reforms and integration within Mercosur contribute to an average annual expansion of 4.9% in the economy.

Exhibit II-17

Paraguay	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	5.0	5.5	7.1	8.8	2.4%	1.0%	1.2%
Real GDP (95\$ bil.)	9.3	12.0	20.2	30.2	5.0%	0.5%	0.6%
Nominal GDP Per Capita (\$)	1,922	2,390	4,055	6,898	5.5%	--	--
Nominal Exports (\$ bil.)	1.02	1.39	2.80	5.54	7.3%	0.4%	0.2%
Nominal Imports (\$ bil.)	4.96	6.71	14.17	29.13	7.7%	1.6%	0.9%
Exchange Rate (NCU/\$)	2,063	2,518	4,286	6,418	4.8%	--	--
Rate of Inflation	9.8%	9.5%	8.1%	6.8%	8.1%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

While Paraguay's economy has achieved modest growth in recent years and the government is continuing to pursue economic reforms, much of the economic activity in the country is uncounted and unregulated. Paraguay is characterized by having a large informal economy that consists of re-exports of consumer goods to neighboring countries and thousands of microenterprises. A large percentage of the population still derive their living from agricultural activity, often on a subsistence basis.

The government has continued to pursue economic reforms including integration within Mercosur. Real GDP growth is expected to grow above 6% in the next few years, before falling over the forecast period. The average annual rate over the period 1997-2020 is forecast at 4.9%.

Market Potential

Paraguay has the highest population growth among Latin American countries. As a result, despite strong economic growth, nominal GDP per capita will not grow faster than the average rate of inflation.

Paraguay's exports are primarily agricultural. Mercosur partners and other Latin American countries are the destination for more than two-thirds of exports. Imported commodities are capital and consumer goods, as well as fuel and food products. The majority of imports are from Brazil, the EU, and other Latin America countries.

Paraguay is a member of the LAIA, Mercosur, and the WTO.

PERU

- ▶ Substantial improvements have been made in Peru's economic growth and inflation, but Peru still faces high medium-term risk to continued achievements.
- ▶ Extremely slow growth in nominal GDP per capita will drop average income in Peru to fourteenth place in Latin America by 2020.

Exhibit II-18

Peru	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	24.0	26.0	31.2	37.3	1.9%	5.0%	5.2%
Real GDP (95\$ bil.)	66.7	82.1	133.2	202.6	4.7%	3.8%	4.1%
Nominal GDP Per Capita (\$)	2,910	3,085	3,769	4,766	2.1%	--	--
Real Private Consumption (95\$ bil.)	50.8	58.2	85.5	129.5	4.0%	--	--
Real Public Consumption (95\$ bil.)	3.5	4.0	5.5	7.5	3.3%	--	--
Real Fixed Investment (95\$ bil.)	16.7	22.4	39.1	55.9	5.2%	--	--
Nominal Exports (\$ bil.)	9.5	14.0	30.6	70.5	8.7%	3.7%	2.5%
Nominal Imports (\$ bil.)	12.3	16.7	37.9	87.9	8.5%	4.0%	2.8%
Exchange Rate (NCU/\$)	2.45	3.58	7.23	11.85	6.8%	--	--
Rate of Inflation	11.8%	8.3%	6.3%	4.6%	6.3%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Peru has moved decisively to overcome what only a few years ago seemed like insurmountable obstacles. The government's fierce anti-insurgency campaign left the guerrillas of both the Sendero Luminoso (Shining Path) and the Movimiento Revolucionario Tupac Amaru (MRTA) on the defensive, with their military threats greatly reduced. The government's repeated claim of having eliminated the MRTA is an exaggeration, however. In fact, both insurgent groups are still active in many areas. The recent hostage crisis, while an isolated incident, was a blunt reminder of this reality. High-level corruption among the military and police forces remains a significant impediment to controlling crime as well as insurgency and terrorism.

A new challenge facing Peru is El Niño. The government has so far spent in excess of \$110 million fighting El Niño's effects. Damages are estimated at \$60 million, relatively low because of preventive measures that were initiated. These costs come at a time when tax revenues will be reduced as a result of fewer exports to Asia. Rather than tighten fiscal expenditures or cut back on his vote-winning expenditures, Fujimori will likely ask congress to approve additional funds.

Despite El Niño, Peru posted one of the highest growth rates in Latin America. GDP growth for 1997 was 5.3% and inflation came in at 9.5%. This is a substantial improvement over the 1996 figures of 2.8% growth and 11.5% inflation. The trade deficit is expected to widen due to falling metal and commodity prices, and El Niño's devastation of the fishing sector, Peru's second-largest export industry. The fishing industry fell 73.7% year-on-year in December.

More importantly, Peru's achievements have yet to stand the test of time. Political violence has waned, but it could return if growth slows and current social spending plans lose funding. The government is moving in the right direction by emphasizing a social agenda, liberalizing investment laws, and controlling inflation—but more time is needed for these measures to restructure the economy. While Peru has a relatively moderate short-term risk for a Latin American country, its medium-term risk is high.

Two of the largest constraints to domestic growth are the current-account deficit and government debt. In 1996, the government engineered an economic slowdown that made a marginal improvement in the trade balance, but reduced GDP growth by more than half: from 7.0% in 1995 to 2.8% in 1996.

In the next year, and in a slightly declining trend during the next five years, Peru's currency will remain vulnerable given the magnitude of the foreign flows now required to finance the external gap and the returning concern about guerrilla activity. Foreign currency inflows remain strong, and Peru's ability to obtain fresh commercial financing has been boosted by the signing of a Brady deal. While the current-account deficit has improved, it remains at high levels in the midst of nervous international markets—a risky combination.

The inflation rate has fallen from more than 7,400% in 1990 to 9.5% in 1997. Inflation reduction remains an important item in the government's agenda. Further reductions will be slower, however, due to capital inflows and the government's planned increases in social spending.

In the next few years, real GDP will grow at a pace faster than 5%, after which it will decline gradually. On average over the long term, real GDP is forecast to increase at 4.7%.

Market Potential

Peru's nominal GDP per capita is well below the Latin American average. At \$2,973 in 1997, it ranks 14th out of the Latin American entities considered here. Peru is also forecast to have the slowest growth in nominal GDP per capita of all the countries in this forecast. Real public and private consumption will also increase relatively slowly, while fixed investment will grow somewhat faster at 5.1% per annum.

The recent trend in exports has been quite positive. Private firms have helped raise productivity and investment, particularly in key mining sectors. However, in the medium term, the preservation of security is necessary for investment in the minerals and agricultural sectors. It is also important to maintain stable and predictable inflation and interest rates. The current outlook for these variables is positive. Nominal exports and imports are forecast to increase at an annual rate of 8.5% in the next 23 years, an average rate for Latin American economies. Peru is a member of the LAIA and the Andean Pact, however it did not participate in the most recent negotiations of the Andean Pact.

URUGUAY

- ▶ Recent political and economic restructuring in Uruguay have brightened its economic outlook, for a forecast average of 4.5% in GDP growth over the next 23 years.
- ▶ Nominal GDP growth per capita ranks fifth among Latin American entities, growing at a pace of 6.9%.

Exhibit II-19

Uruguay	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	3.2	3.3	3.5	3.7	0.6%	0.7%	0.5%
Real GDP (95\$ bil.)	18.5	22.0	36.8	53.5	4.5%	1.0%	1.1%
Nominal GDP Per Capita (\$)	5,907	7,381	14,890	29,019	6.9%	--	--
Nominal Exports (\$ bil.)	2.42	2.97	5.72	10.87	6.5%	0.9%	0.4%
Nominal Imports (\$ bil.)	3.75	5.39	13.68	31.29	9.2%	1.2%	1.0%
Exchange Rate (NCU/\$)	7.97	13.34	18.84	19.79	3.9%	--	--
Rate of Inflation	28.3%	10.6%	4.9%	3.4%	6.8%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

From being one of the most developed economies in Latin America in the past, Uruguay has lost much ground. Since 1950, its average economic growth has been well below the regional average. The causes of Uruguay's economic stagnation during the last four decades are numerous: a bloated public sector, an excessive tax burden, lax monetary and fiscal policy, capital flight and emigration, declining competitiveness, unfavorable terms of trade, party factionalism, and political instability.

In recent years, however, Uruguay has made some efforts to reform its economy and to move toward sustainable development. President Julio María Sanguinetti, who was inaugurated in March 1995, is far more committed to fiscal reform and economic restructuring than were his predecessors. Moreover, he has been more successful in getting both his political and economic programs through the divided national assembly. The results were very positive for the business community and foreign investors. A new constitutional arrangement improves the prospects for further economic reform after the next national elections in 1999.

Uruguay's greatest economic assets are its highly skilled work force, well-developed infrastructure, and attractive tourism resources. In addition, its proximity to the two largest South American economies and its membership in Mercosur enhances its investment potential beyond its own relatively small economy. Uruguay's economy faces a number of risks, however. Its dependence on neighboring countries' markets means that its economic growth is hurt by recessions in those nations, particularly in Argentina. Its generous system of state-funded social and health benefits is a major burden on the economy, even after recent reforms. The country's propensity for holding referendums on every major political issue reduces the government's latitude for dealing with problems that require tough—and often unpopular—action. The division of political power in the national assembly among numerous small political factions, loosely grouped into three broad coalitions, rules out strong governments capable of decisive action. This limited decision latitude is further restricted by the tendency of the labor unions to oppose government austerity and restructuring through strikes.

After a three-year economic boom during 1992-94, when annual GDP growth averaged nearly 6%, the economy slid into recession in 1995, contracting by 2.4%, due to an austere budget, recession in Argentina, and a slowdown in Brazil (Uruguay's two major trading partners). The recovery last year was a surprisingly strong 4.8%, but the outlook for 1998 has turned negative as a result of likely slowdowns in Brazil and Argentina—also Uruguay's primary sources of tourist income—as well as a possible reduction in exports to Asia, and a decrease in agricultural output from heavy rainfall due to El Niño. Over the forecast interval 1997-2020, average annual growth of 4.5% in real GDP is expected.

Market Potential

Uruguay's double-digit unemployment rate is a major source of concern for the government and a potential danger to the country's macroeconomic stabilization program. Although still very high, unemployment has maintained its gradual downward trend in recent months, falling from 12% in December 1996 to 10.8% in October 1997.

With the decrease in unemployment, per capita incomes will increase. Slow population growth and strong GDP growth contributes to a strong increase in GDP per capita in the future; nominal GDP per capita will grow at 6.9%. At over

\$6,200, Uruguay's nominal per capita GDP is already high by regional standards. Trade in Uruguay is forecast to grow even faster.

Nonetheless, Uruguay is a small country, with a population of only 3.2 million in 1997. While incomes, domestic consumption, as well as imports and exports are increasing, Uruguay will remain a small market compared to its neighboring Latin American economies.

Uruguay is a member of Mercosur, the LAIA, and the WTO.

VENEZUELA

- ▶ As Venezuela lags most other South American countries in economic liberalization, only moderate GDP growth, 4.2%, is forecast for the next 23 years.
- ▶ Oil continues to dominate government revenues and exports.

Exhibit II-20

Venezuela	1996	2000	2010	2020	Average Ann. Growth, 1996-2020*	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	22.2	24.3	30.5	38.2	2.3%	4.7%	5.3%
Employment (mil.)	7.1	8.2	11.2	15.3	3.2%	0.4%	0.3%
Real GDP (95\$ bil.)	81.4	94.8	147.6	215.5	4.1%	--	--
Nominal GDP Per Capita (\$)	3,459	4,879	7,408	11,489	5.1%	--	--
Real Private Consumption (95\$ bil.)	52.0	61.8	88.5	125.3	3.7%	--	--
Real Public Consumption (95\$ bil.)	6.0	7.1	10.8	16.4	4.3%	--	--
Real Fixed Investment (95\$ bil.)	10.6	14.1	25.6	37.1	5.4%	--	--
Nominal Exports (\$ bil.)	24.3	27.8	59.9	129.0	7.2%	8.0%	4.0%
Nominal Imports (\$ bil.)	13.7	25.0	60.2	135.3	10.0%	4.5%	4.2%
Exchange Rate (NCU/\$)	417.5	991.4	6418.2	40,221	21.0%	--	--
Rate of Inflation	99.4%	24.3%	23.3%	23.5%	22.8%	--	--

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Egregious government mismanagement has long been the most critical economic problem in Venezuela. In seven of the past ten years, the fiscal accounts have been in deficit, averaging 3.4% of GDP over the entire period. Moreover, government spending has often focused on short-term gain rather than long-term growth prospects. Indeed, a significant portion of expenditures has consistently subsidized local industry and domestic consumption. Venezuela lags most other South American countries in economic liberalization. On the positive side, though, the country's democratic institutions remain strong and stable despite the turmoil of the early 1990s and the hardships caused by the economic crisis.

The depth of the economy's malaise forced the Caldera administration to start moving toward economic reform. With the help of the IMF—which forced the

government into it as a prerequisite for a standby agreement signed in April 1996—Caldera began to implement reforms under the program Agenda Venezuela. The removal of exchange controls, along with inflation reduction and the expansion of privatization, have improved business sentiment and attracted more foreign capital. Venezuela's initial success at reform and improvements in its fiscal and trade accounts was rewarded by a Standard & Poor's upgrade of its foreign currency debt rating from B to B+ (still below the country's high of BB-four years ago). This pat on the back will not only attract more attention from foreign investors, but also reduce the cost of future borrowing. Although the government has now turned to deal with the costly severance-pay system and salary indexation to inflation, the political will to pursue further economic reforms is questionable.

Oil accounts for two-thirds of government revenue. Venezuela, already with a reputation as OPEC's largest quota buster, is unlikely to reduce its output to abide by OPEC's quota, because it cannot afford to forego the revenue that such a step would imply. Venezuela's excessive reliance on oil revenues makes its economy highly vulnerable to sudden drops in oil prices.

The central bank reported that the economy registered 5.1% economic growth for 1997. The oil economy expanded 8.8% and the non-oil economy reported 3.3% gains, although employment growth was mainly in the non-oil sector. Government officials expect GDP to increase 5.4% in 1998, but with the oil market prospects poor for the remainder of the year and much of the world economy entering a slower growth phase, the potential for even slower expansion is significant. The privatization program has continued to move faster than expected, but still at a modest pace. Although Venezuela has managed to reduce its inflation from 103% in 1996 to 51.4% in 1997, it still has one of the highest inflation rates on the continent.

The current anti-inflationary strategy rests, for the most part, on the use of the nominal exchange rate as an anchor for domestic prices. Monetary policy, which was extremely tight after the introduction of the stabilization package, has struggled to prevent the money supply from increasing at fast rates, given the rapid reserve buildup that has taken place since May 1996. The anti-inflationary strategy has been limited, to some extent, by its reliance on central-bank instruments to reduce market liquidity.

In the long run, Venezuela's economic prospects largely revolve around economic reform—not just oil prices and volumes. Inflation control and economic diversification are two necessary keys to success. Due to the government's unwillingness to pursue more substantive reforms, there is a moderate growth outlook for Venezuela. Although the oil sector will continue to bring ups and downs, overall GDP growth should average around 4.2% per year.

Market Potential

Population growth in Venezuela is forecast to grow at an annual rate of 2.3%, a rate second only to Paraguay. While nominal GDP per capita is also forecast to grow very strongly, real income will be eroded by the high rate of inflation in

Venezuela. Real public consumption is forecast to grow slightly faster than private consumption. Real fixed investment will increase the most rapidly, at an average pace of 5.1% through 2020.

Manufacturing exports are relatively insignificant in Venezuela. Given the overwhelming weight of oil in Venezuelan exports, the risk of a large decline in export volumes is closely associated with conditions in the international oil markets. Manufacturing and agricultural exports will continue to be damaged by the strong bolívar. The current outlook for Venezuelan exports is a nominal growth of 7.8% per year, while a strong currency will help imports grow at 9.9% annually.

The risk of a damaging trade conflict is small but not negligible, as recent frictions with Andean-pact partner Colombia suggest. The lifting of exchange controls in 1996 improved trade flows with neighboring countries, particularly Colombia. Recent moves to initiate talks with Mercosur regarding eventual membership should also contribute to keeping this risk moderate over the five-year horizon.

Venezuela is a member of the Andean Pact, the Group of Three, the WTO, and has an agreement with CARICOM.

OTHER CARIBBEAN ECONOMIES

- ▶ Economic growth will continue at an annual average pace of 2.5% over 1997-2020.

Exhibit II-21

Other Caribbean Countries	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	3.0	3.0	3.1	3.4	0.4%	0.6%	0.5%
Real GDP (95\$ bil.)	21.0	23.6	30.7	38.7	2.6%	1.2%	0.8%
Nominal GDP Per Capita (\$)	7,131	8,598	13,833	23,181	5.0%	--	--
Nominal Exports (\$ bil.)	5.94	5.93	7.04	9.15	1.8%	2.3%	0.3%
Nominal Imports (\$ bil.)	13.44	14.84	22.11	34.27	4.0%	4.4%	1.1%

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Economic growth will continue at an annual average pace of 2.5% over 1997-2020.

Market Potential

Many of the Caribbean islands have GDP per capita levels very high for the region, due to their attraction as financial havens and tourist destinations. Bermuda, the Cayman Islands, the British Virgin Islands, and Martinique have the highest GDP per capita. The forecast growth rate for GDP per capita growth is 2.8%.

Exports and imports are forecast to grow only moderately at 2.0% and 4.1%, respectively.

Most of the Caribbean islands are part of CARICOM, the CBI, and CARIBCAN.

OTHER CENTRAL AMERICA ECONOMIES

- ▶ Combined, Central American countries have among the lowest GDP per capita levels in Latin America.
- ▶ GDP growth is forecast at a slow pace of 1.7% over the forecast period.

Exhibit II-22

Other Central American Countries	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of Latin America 1996	Share of Latin America 2020
Population (mil.)	30.5	33.6	41.3	49.2	2.0%	6.4%	6.8%
Real GDP (95\$ bil.)	36.9	39.0	47.6	54.6	1.6%	2.1%	1.1%
Nominal GDP Per Capita (\$)	1,235	1,283	1,630	2,228	2.5%	--	--
Nominal Exports (\$ bil.)	9.57	13.76	27.79	52.25	7.3%	3.7%	1.9%
Nominal Imports (\$ bil.)	14.78	20.79	43.13	77.81	7.2%	4.8%	2.4%

*The figure reported for rate of inflation in this column is the average annual growth rate in CPI, or the average rate of inflation in 1997-2020.

Economic Overview

Other Central American countries are Belize, Guatemala, Honduras, Nicaragua, El Salvador, and Costa Rica. Within the region, there are differences in population size, GDP per capita, and trade levels. Belize is the smallest country in population, and its colonial history separates it somewhat from the rest of the region. Guatemala is the largest Central American country in terms of population and economy, but has a lower income level due to past civil conflicts and the agrarian focus of large segments of its population. Costa Rica, with the smallest population other than Belize, has had the steadiest economic growth in the region and had avoided the civil conflicts that other countries in the region have suffered.

With substantive economic reforms still needed in most of the region, relatively slow economic growth is forecast in the region. The combined regional economies are forecast to grow at an average rate of only 1.7% over the next two decades. Growth will peak in 2000 at 2.8%, after which the forecast rate will decline.

Market Potential

Combined, the Central American region has one of the slowest GDP per capita growth rates in Latin America, ranking sixteenth out of nineteen. At a country

level, Belize and Costa Rica have the highest GDP per capita in Central America, while Honduras and Nicaragua have the lowest.

All of the countries import more than they export, with Costa Rica and Guatemala the dominant exporters. Over 1997-2020, exports are forecast to grow at an annual average pace of 7.2%, while the larger import value grows slightly slower at 7.0%.

All Central American countries are members of the Central American Common Market and the Caribbean Basin Initiative. Guatemala, Honduras, Nicaragua, and El Salvador form the System of Central American Integration. As well, Belize is a member of CARICOM and CARIBCAN.

WORLD REGIONS

CANADA OVERVIEW

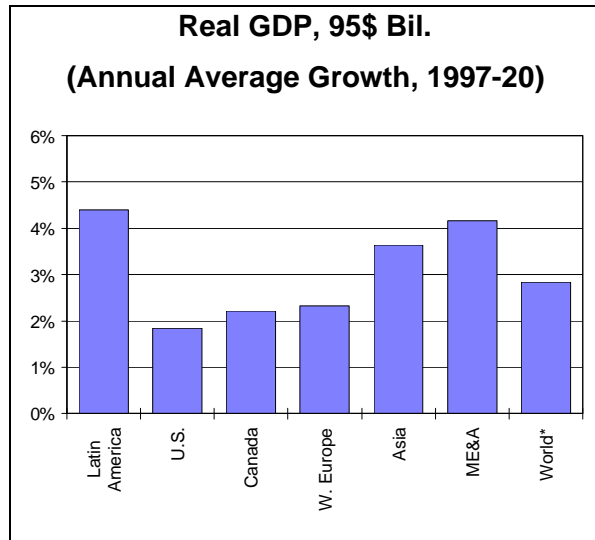
Economic Overview

The Canadian economy is moving ahead steadily. Very loose monetary conditions have provided the spark needed for the economy to lift itself from its lethargic performance of 1995 and 1996. The economy expanded at a 3.8% annual rate during 1997 and should continue to grow well this year, at 3.5%. Over the next 23 years, the Canadian economy is forecast to grow at an average annual pace of 2.2%—marginally slower than Western Europe, but faster than the U.S.

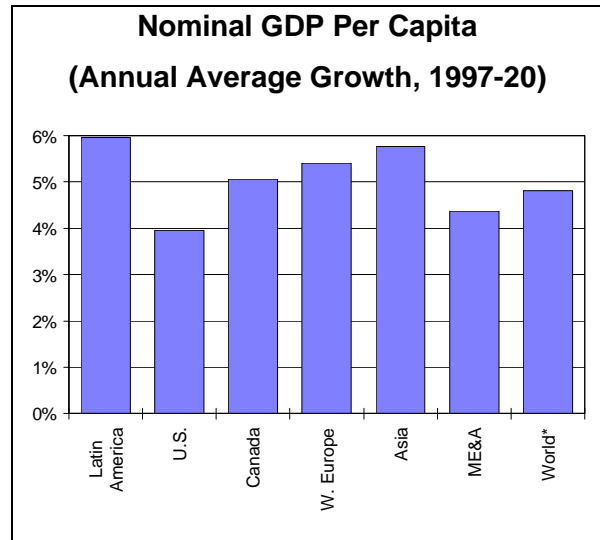
Interestingly enough, since growth in Canada has been quite strong relative to its performance in recent years, imports have risen enough so as to cause net exports to become a drag on the economy. Another important development is the strong employment gains in the past year; more than 300,000 positions were added to the economy, which will add to the expansion's durability, since personal disposable income will increase.

Federal deficits are falling as a result of increased tax revenues, and a surplus of \$1.7 billion for the current fiscal year is expected—the first federal surplus in almost 30 years. The government's financial requirements will become a financial source, allowing it to retire some existing debt.

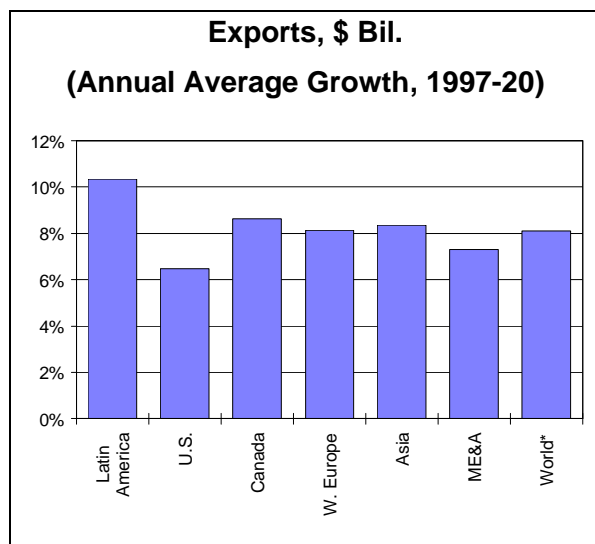
**Exhibit II-23
FORECAST GROWTH RATES: 1996 – 2020
VARIOUS ECONOMIC INDICATORS**



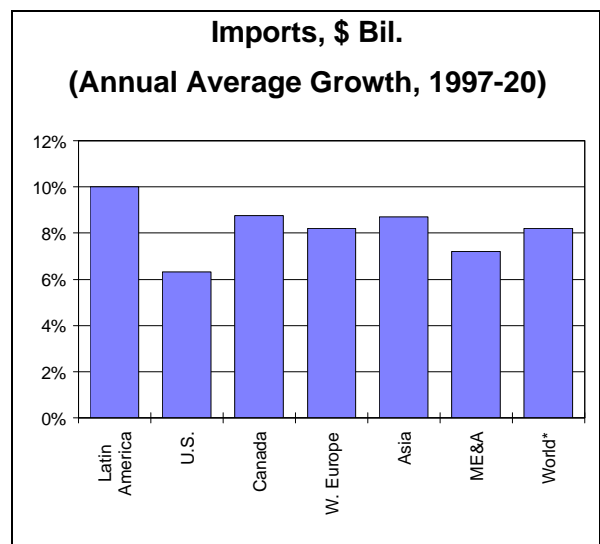
*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.



*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.



*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.



*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

Exhibit II-24

Canada	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	30	31	34	36	0.8%	0.7%	0.6%
Real GDP (95\$ bil.)	589	661	863	1,013	2.3%	2.1%	1.8%
Nominal GDP Per Capita (\$)	20,175	23,387	40,639	63,756	4.9%	--	--
Nominal Exports (\$ bil.)	235	309	760	1,667	8.5%	3.9%	4.5%
Nominal Imports (\$ bil.)	212	306	719	1,647	8.9%	3.6%	4.4%

Earlier in the 1990s, the high real cost of labor relative to its productivity kept firms from hiring. This imbalance was largely due to faster growth in wages and salaries relative to labor productivity during the previous decade. The process of rebalancing labor costs and productivity has, for the most part, been completed. Therefore, it has become cost-effective for firms to start hiring again. It is anticipated that the surge in employment over the past year will be sustained as firms take advantage of the large pool of available workers, many of whom have reentered the work force. Strong employment growth will bolster personal incomes and allow consumers to continue to spend even after their pent-up demand has been satiated.

Much of the strong gain in machinery and equipment (M&E) investment has been due to the explosion in computer equipment and other office equipment spending. The rebound in non-office equipment investment, however, has significantly lagged in this cycle compared with its performance in the 1980s. Consequently, there is likely to be a significant, albeit delayed, bounce-back in demand for non-computer assets as the private-sector rebound continues. Some of the business investment normally spent on other types of equipment, though, has been diverted to office equipment. This implies that the ultimate rebound in non-computer equipment, although substantial, will be less buoyant than in the past. Overall investment has been boosted by the current low-inflation/low-interest-rate environment.

International Linkages

Canada's export exposure to Asia is small—only about 8% of total exports go to that region—so the Asian crisis will have a minimal direct impact on the economy. The crisis may have a greater indirect effect on Canada through its effect on the United States. Since a significant portion of U.S. trade (20%) is with the Asian countries, the U.S. economy will see a stronger impact from the crisis. Indeed, the 1998 forecast for U.S. growth has been downgraded by 0.3% due to the Asian crisis. The slower-growing U.S. economy will affect the Canadian economy, since over 82% of Canada's trade is with the United States. Nominal export and imports are forecast to grow at an annual average rate of 8.6% and 8.8%, respectively.

WESTERN EUROPE OVERVIEW

Exhibit II-25

Western Europe	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	447	456	477	497	0.4%	10.1%	8.2%
Real GDP (95\$ bil.)	9,194	10,116	12,708	15,986	2.3%	32.7%	29.0%
Nominal GDP Per Capita (\$)	20,609	22,985	37,866	64,484	4.9%	--	--
Nominal Exports (\$ bil.)	2,723	3,486	7,366	16,046	7.7%	45.6%	43.4%
Nominal Imports (\$ bil.)	2,543	3,198	6,778	15,129	7.7%	43.0%	40.8%

**World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.*

Economic Overview

Although the four main EU economies—Germany, France, the UK, and Italy—continue to post different growth patterns, with economic activity in the UK decelerating while the other countries are still on the upward phase of the business cycle, overall real GDP growth in the EU continues to strengthen.

The improvement of overall growth performance in the EU in 1997 reflects mainly a positive contribution of net real trade to European growth, and a slow improvement in the domestic sector's contribution to growth. On the domestic front, real private consumption was buoyant in the UK and Italy in 1997, but has been nearly stagnant elsewhere.

The continued rise in unemployment in European countries—it stands at 10% in western Germany and 12.9% in France—plus moderate pay rises and a tightening of fiscal policy as both countries struggle to meet the public deficit target for EMU, has meant very low (negative in Germany) real income growth. The moderate outlook for growth over the forecast period, combined with continued fast productivity growth in manufacturing and accelerating productivity growth in the services sectors, will lead to only slow improvements in the labor markets.

Business investment spending is expected to be the main engine of domestic activity in 1998, in particular investment in machinery and equipment. Despite the recent hikes in interest rates, monetary policy remains relatively loose, and all underlying conditions for investment have improved.

Economic growth will remain strong in 1998, at 2.6%, and then decline gradually. Over the forecast period 1997-2020, real GDP growth will average 2.3%.

International Linkages

As Europe's exposure to world demand is moderate in general (much of its trade is intra-Europe), and much of Europe's external trade is oriented towards other industrialized countries, the direct impact of changes in import demand from Asia on Europe's exports will be limited. The impact on corporate profits of European

companies will also be moderate, since European ownership in Asia is much less than either Japan or the United States. The two effects that will drive Europe's response to the Asian crisis are the reduction in world trade growth and the appreciation of effective exchange rates, which reduces export price competitiveness. The limited impact of the Asian crisis on European growth also stems partly from the fact that the engine of European growth over the coming years was already anticipated to come mainly from domestic demand—both private consumption and investment—as opposed to trade.

As mentioned above, the improvement in GDP growth in the EU has been largely trade-led. Both German and French exports increased by more than 10% in 1997, while UK export growth remained stable at close to 7%—a strong performance given the appreciation of sterling. In comparison, Italy's exports grew only slowly, due to the appreciating lira and to high domestic demand growth. For the Western Europe region as a whole, both nominal exports and imports are forecast to grow at a steady pace just over 8% per year through 2020.

ASIA OVERVIEW

Exhibit II-26

Asia	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	2,885	3,052	3,463	3,885	1.2%	65.0%	64.4%
Real GDP (95\$ bil.)	8,508	9,366	13,650	19,820	3.6%	30.3%	36.0%
Nominal GDP Per Capita (\$)	2,735	2,701	4,943	9,412	5.3%	--	--
Nominal Exports (\$ bil.)	1,705	2,148	5,084	11,448	8.3%	28.5%	31.0%
Nominal Imports (\$ bil.)	1,705	2,047	5,066	11,884	8.4%	28.8%	32.0%

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

Economic Overview

Political risks in Asia have escalated as the increased frequency of labor conflicts and higher potential for major urban riots take their toll. The unprecedented regional economic decline has also raised the scope for increased crime and corruption as unemployment increases, incomes diminish, and the economic pie shrinks dramatically in size. On the positive side, supply-side shortages and cost-push pressures will be eased due to the easing of domestic demand.

There is little doubt that Thailand, South Korea and Indonesia will experience deep recessions this year. Indonesia is likely to suffer through an especially painful downturn because it has failed to implement the reforms mandated by the IMF. The threat of hyperinflation looms large; there have been food shortages and panic buying. Imports have collapsed as usable reserves and trade financing has dried up.

Korea's financial crisis has eased considerably recently. The Korean *won* has made a dramatic recovery since late December, albeit with some volatility. The economic crisis in South Korea has overshadowed the economic problems of North Korea and the ever-present dangers of a military clash between the two states. Yet, these two issues could easily become the gravest threats to South Korea's economic future. A government collapse in the North could lead to chaotic mass migration to the South; and any minor military clash could easily escalate into a major war that would destroy most of South Korea's economy.

Asia's financial turmoil will have a major impact on Malaysia's real economy through 1999. Malaysian exports—25% of which go to ASEAN countries and 40% to Asia as a whole—could also decline as a result of the drop in regional demand. The weakness in surrounding economies will deny Malaysia the opportunity to export its way out of the slowdown. To make the situation worse, Malaysia's foreign exchange income from primary commodity exports will decline substantially due to weak international prices.

While China is unlikely to suffer through a full-blown recession, the risk of a large cyclical downturn is quite high. Domestic demand has been quite weak, export growth is about to come to a grinding halt because of the real effective appreciation of the renminbi, and foreign direct investment has already shrunk. The restructuring of the manufacturing sector, if it happens, could lead to a large rise in unemployment. These, in turn, could trigger more social unrest, although short-term political risks in China are still quite low.

Japan's economic situation remains dismal. Up till now, Japan's recovery has relied on the strength of exports. The rapid depreciation of Southeast Asia's currencies since July 1997 has made Japanese goods relatively more expensive, threatening near-term export growth. At the same time, domestic demand remains limp and the government seems unwilling to take the necessary corrective action. The Japanese have made it clear that the political constraints binding them are inescapable at this point in time, and that they remain determined to prevent a more expansionary policy. The economy will thus continue to rely on exports at a time when Asian export markets remain weak or are heading into recession.

Taiwan's real economy will suffer a relatively minor setback this year, compared with most other Asian nations. With 55% of Taiwan's exports going to Asian countries, the expected drop in regional import demand could have a significant negative impact on its exports. The island's prudent macroeconomic policies and good fundamentals should minimize any contagion effects on its financial markets, however.

India's recent elections have not resolved its fragmented politics. Risks to economic activity have accelerated in response to the Asian crisis and domestic political uncertainty. Industrial output has failed to exhibit any significant signs of a pick-up. Nevertheless, India is unlikely to catch a full case of the "Asian flu."

Australia's economy will ease from its 1997 level, reflecting the weakening outlook for the country's commodity exports and sharply lower Asian tourist

arrivals. In contrast, domestic demand will continue to show signs of burgeoning growth in the first half of 1998, as consumer and business confidence maintain their current momentum. Weak export demand and the impact of falling commodity prices, however, will eventually undermine business confidence and increase the risk of a slowdown in overall economic growth. New Zealand has been caught in a situation where domestic demand is outstripping output growth; a situation made worse by weak export growth prospects.

As a region, real GDP growth will fall to 1.5% in 1998, then gradually improve to 3.2% by 2000. Over the entire forecast period, it will average 3.6%—below the growth forecast for Latin America, but still well above the world average.

International Linkages

The slowdown in Southeast Asia should have a significant impact on the rest of the world. Japan will be hit the hardest: roughly half of its exports go to Asia. Since about one-third of U.S. exports go to Asia (including Japan), U.S. growth is likely to be reduced by 0.3-0.5 percentage points. But less than 10% of Europe's exports are bound for Asia; therefore, the impact of the Asian downturn on European growth will be quite modest. Overall, the direct and indirect effect of the Asian crises could reduce real world GDP growth by as much as half a percentage point.

The benefits of cheaper currencies will be harder to realize than during the Mexican crisis of 1994-95, since Asian countries tend to trade heavily with each other. Export potential will also be limited for commodity-exporting nations by falling world prices for commodities. Even though a reversal in the trade-oriented outward orientation that has reaped rich rewards for the region's economies in the past is not anticipated, enforceability of contracts is expected to face new pressure and default risks rise as ailing banks and companies struggle to balance their asset/liabilities ratios. In the near term, export and import growth rates for the region will fall from highs over 6% to 2% in 1998. Improvement is expected by 1999, and growth rates will increase over the forecast period. On average, growth in nominal exports and imports is forecast at 8.3% and 8.7% respectively over 1997-2020.

REST OF WORLD OVERVIEW

Exhibit II-27

Middle East & Africa	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	334	368	462	569	2.2%	7.5%	9.4%
Real GDP (95\$ bil.)	550	630	956	1,438	4.1%	2.0%	2.6%
Nominal GDP Per Capita (\$)	1,674	1,787	2,809	4,630	4.3%	--	--
Nominal Exports (\$ bil.)	184	205	424	920	6.9%	3.1%	2.5%
Nominal Imports (\$ bil.)	187	218	444	938	7.0%	3.2%	2.5%

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

Economic Overview

Iran's short-term economic outlook has deteriorated because of a sharp fall in oil prices, but the country's long-term outlook has improved as a result of President Seyyed Mohammad Khatemi's pragmatism and further improvement in Iran's relations with Arab nations, the United States, and other Western Countries. Meanwhile, Israel's economic picture continues to worsen. Recent revised data show that real GDP grew by only 1.9% in 1997, compared with 4.5% in 1996. The slowdown has largely been due to a sharp drop in investment since Prime Minister Netanyahu took over Israel's government.

Iraq remains one of the riskiest countries in the world, largely due to the pathological tendencies of its president, Saddam Hussein. During the last quarter, once again, violations of the terms of the 1991 Gulf War cease-fire agreement by Iraq caused a crisis that ended only after a U.S. military show of force. As in previous such incidents, Iraq's actions undermined its diplomatic efforts to have the U.N. sanctions lifted; but they helped the country gain public sympathy in the Third World, particularly among Arab and Muslim populations. The crisis also helped Saddam's regime gain revenues by manipulating prices of foreign currencies and essential commodities in the local market.

Algeria's risks continue to be very high, given its social and political turmoil, coupled with its over-dependence on volatile energy and agriculture sectors. Although Algeria's social and political situation went from bad to worse during the last quarter, the country's economy remained relatively strong.

International Linkages

Exports from the region will be affected by lower oil prices—which will have a large impact on government revenues and import capabilities. Nominal growth in exports, recovering from negative growth in 1997, will improve to 3.8% in 1998, and struggle back to approximately 8.0% by 2005, for an average growth rate of 7.3% over 1997-2020. Imports will rise more gradually, from 2.4% in 1998, to achieve an average of 7.2% over the forecast period.

Exhibit II-28
**ADDITIONAL FORECAST EXHIBITS
 FOR THE UNITED STATES ECONOMY**

U.S.	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	266	275	298	323	0.8%	6.0%	5.3%
Real GDP (95\$ bil.)	7,466	8,231	10,241	11,801	1.9%	26.6%	21.4%
Nominal GDP Per Capita (\$)	28,725	32,997	48,591	73,458	4.0%	--	--
Nominal Exports (\$ bil.)	871	1,121	2,415	4,055	6.6%	14.6%	11.0%
Nominal Imports (\$ bil.)	966	1,259	2,380	4,327	6.4%	16.3%	11.7%

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.

Exhibit II-29
**ADDITIONAL FORECAST EXHIBITS
 FOR THE WORLD ECONOMY**

World* (Excluding E. Europe, FSU, many Asia & most Africa)	1996	2000	2010	2020	Average Ann. Growth, 1996-2020	Share of World* 1996	Share of World* 2020
Population (mil.)	4,438	4,695	5,346	6,034	1.3%	100.0%	100.0%
Real GDP (95\$ bil.)	28,080	31,118	41,740	55,057	2.8%	100.0%	100.0%
Nominal GDP Per Capita (\$)	77,180	87,861	142,064	229,102	4.6%	--	--
Nominal Exports (\$ bil.)	5,975	7,663	17,143	36,932	7.9%	100.0%	100.0%
Nominal Imports (\$ bil.)	5,917	7,514	16,666	37,114	8.0%	100.0%	100.0%

*World totals exclude Eastern Europe and the former Soviet Union, many Asian countries, and most of Africa.