G20 meet reflects shift in world economic balance

AFP, *Xianghe, China*

International financial bodies need to reflect the impact emerging powers are having on the global economic landscape, finance chiefs said at a weekend meeting hosted by China.

The Group of 20 also warned of high oil prices, trade barriers and economic imbalances -- all key issues involving energy-hungry China, the world's fastest growing major economy that is running a huge trade surplus with the West.

The finance ministers and central bank chiefs meeting outside Beijing also agreed on a "roadmap" to reform the International Monetary Fund (IMF) and World Bank, to give more say to booming newcomers from Asia and elsewhere.

The G20 was founded in 1999 to enhance dialogue between the Group of Seven industrialised nations and population giants such as China, India and Brazil as well as other key economies, including oil-rich Saudi Arabia and Russia.

The grouping is now considered an informal forum for debate but organisers point out that its members account for two thirds of the world population, 80 percent of its trade and 90 percent of global economic output.

"So far the G20 is still a talk shop and no major decisions have been made," said Andy Xie, Morgan Stanley's Asia Pacific chief economist.

"But I think eventually the G20 could replace the G7 in importance. The biggest problems in the world relate to the diverging interests between big developing and developed countries."

In the long run, he said, economic issues should be discussed between six key players: the largest economies, the United States, European Union and Japan, and the largest developing countries -- China, India and Russia.

The G20 responded to criticism that world financial bodies such as the Bretton Woods Institutions (BWIs) -- the IMF and World Bank -- still reflect the economic power balance of the time they were founded over 60 years ago.

"The world economy has evolved considerably since the founding of the BWIs, with fast growth in many emerging markets and deepened integration in industrialized countries," they said in a final statement.

"We reaffirm the principle that the governance structure of the BWIs -- both quotas and representation -- should reflect such changes in economic weight."

Australian Treasurer Peter Costello, who will chair next year's G20 meeting in Melbourne, said there had been a "recognition that, as the world economy has changed, so too these organisations must change."

The emergence of the new economic powers would have a growing global impact by increasing competition for resources, he said.

"Those economic powers naturally are going to be looking for resource and energy security to drive industrialisation and economic growth. This will become a key question for the international community."

As the fastest-growing of the emerging powers, host China was eager to present itself as a future economic heavyweight with a glorious and important past.

The tightly-managed meeting was held at 'Grand Epoch City', a sprawling complex near Beijing that is modelled on the Chinese imperial capital of the Ming and Qing Dynasties.

The meeting came at a time when China's export-oriented economy is booming at near 10 percent a year, and during a weekend when the country's second manned space mission only strengthened the idea of a superpower on the rise.

President Hu Jintao opened the event by urging the world to "respect the diversity of development models", an apparent reference of China's blend of free market reforms and tight political control.

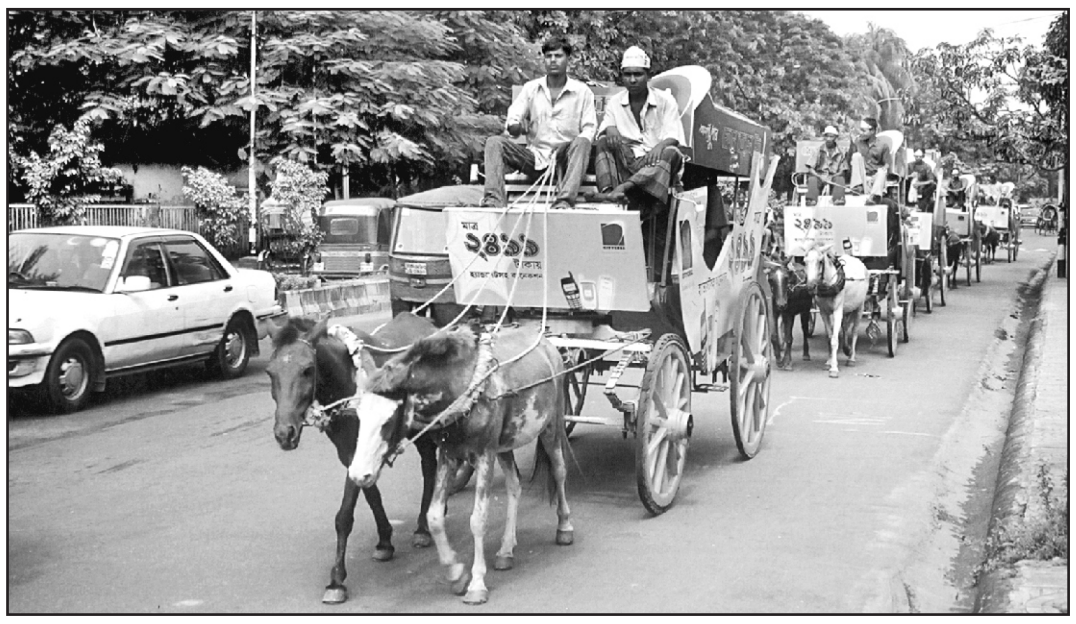

PHOTO: CITYCELL

CityCell organised a roadshow yesterday in Dhaka to promote its 'Aalap Super', a prepaid mobile-to-mobile package, which offers free of charge CityCell-to-CityCell calls during super off peak hours (from 11pm to 8am). The offer is valid until March 31, 2006.

Volkswagen to recast in China

AFP, *Shanghai*

Troubled German carmaker Volkswagen said Monday it would embark on an ambitious cost cutting programme to revive its struggling China operations at its two joint ventures.

It said it would take a variety of measures, such as centralized purchasing, for the two joint ventures and improve cross-venture cooperation between its partners Shanghai Automotive Industry Corp (SAIC) and First Automotive Works.

"We will strive to maintain the leading position and contribute to developing automobile production in China," said Volkswagen China president and chief executive Winfried Vahland.

The economics of oil price adjustment in Bangladesh

SADIQ AHMED

(Continued from Oct 17)

First, while the international crude oil price has gone up by over 200 percent, the domestic prices of kerosene and diesel have increased by 50 percent and the price of petrol has increased by only 27 percent. Since crude oil accounts for some 60-65 percent of the cost of the final products, it is obvious that there still remains a substantial subsidy. Second, how do Bangladesh oil prices compare with other countries in the South Asia Region (SAR)? This is shown in Table 1 below for the 5 major SAR countries expressed in Bangladesh taka per liter. The data suggests that, except for kerosene, domestic fuel prices are highest in India and lowest in Bangladesh even after the price increase of September 05. The gap between India and Bangladesh prices is quite large, with prices in India over 50 percent higher.

Table 1: South Asia Regional Fuel Price Comparison (taka per liter as of September 2005)

Country	Octane	Petrol	Diesel	Kerosene
India (Kolkata)	67	65	46	14
Nepal	--	63	43	37
Pakistan	64	58	38	34
Sri Lanka	54	52	32	20
Bangladesh	45	42	30	30

Regarding kerosene, the product is heavily subsidized in all South Asian countries, with the subsidy particularly large in India and Sri Lanka followed by Bangladesh. Nepal and Pakistan have lower kerosene subsidy. Importantly, Nepal is much poorer than Bangladesh in per capita income terms but has higher fuel prices than Bangladesh.

The recent fuel price increase in Bangladesh in early September was an important step to address the burgeoning subsidy that was fast becoming an unsustainable burden on the macro economy. Even after the increase the subsidy remains very high, some taka 29 billion (0.7 percent of GDP) on an annualized basis and assuming average oil price of $50 per barrel; the subsidy will grow to taka 35 billion (0.8 percent of GDP) if average oil price remains at $60 per barrel. There is lot of unhappiness among consumers and politicians due to the price increase that happened in September. But the reality is that if international oil prices stay at the $50-60 per barrel level, the remaining large subsidy will become unsustainable and further price increases will be unavoidable. Consumers simply cannot assume that the government has deep pockets and will be able to shield them from international price increases. The reality is that Bangladesh has one of the lowest tax to GDP ratio (8.5 percent of GDP) in the developing world. So, large oil subsidies will either require substantial cut backs in development spending that will hurt economic growth and poverty, or increase in deficit financing that will either crowd out private investment or contribute to inflation.

Fuel prices and inflation: Apart from the direct impact of fuel price increase on the income of oil consumers, there is often a fear that this will lead to inflation. There is considerable confusion and misunderstanding on this subject. At the heart of the confusion is the inability to distinguish between relative prices (the price of a commodity/service relative to other prices) and the general price level (which is a weighted average of individual prices). Inflation is defined as the rate of increase in the general price level. When any one commodity or service price goes up, it is not necessarily true that this will lead to inflation. Indeed, other things remaining unchanged, the price increase will reduce real income of consumers of this commodity/service, which in turn will reduce demand for other goods/services, thereby lowering their price. In the final equilibrium the relative price of this commodity will go up, some other prices will come down and there will not be any effect on inflation. However, some commodity/service prices, such as oil, can have a more complex set of adjustment because of the nature of the product. Oil not only is used as a direct consumption item (motor cars) but also as an input in the production chain (irrigation, electricity, transport). As a result, the secondary effects through the input-output processes could lead to a short-term inflationary pressure. This pressure will depend upon the energy intensity of the economy. Empirical evidence from the world economy shows that in terms of inflation both developing and industrial economies have absorbed the oil price shock of 2003-05 much better than during the oil shock in the 1970s. Thus, the developing country inflation rate actually fell to 5.2 percent per annum during 2003-05 as compared with 6.2 percent in 2000-03. In USA, which is the most energy intensive economy in the world and has fully passed through the increase in oil prices to consumers, the inflation rate barely changed from 2.5 percent in 2000-03 to 2.6 percent per annum during 2003-05. The point here is that many other factors determine the likely inflationary effects of oil price increases: the rate of growth of the economy, monetary and fiscal policies, especially their effects on interest and exchange rates, other commodity prices, etc. Ironically, those who fear that oil price increase will fuel inflation in Bangladesh do not worry that financing the oil subsidy through bank borrowing as presently is more harmful for inflation than the increase in oil prices!

Oil prices and the poor: The other populist argument is that the increase in oil prices will hurt the poor. For that matter, increase in any commodity or service price consumed by the poor will of course hurt the poor given that it will reduce their purchasing power. Bangladesh did follow a policy of price controls during the early 1970s with disastrous economic consequences. The real issue is not so much as price controls and subsidies to protect the poor, but whether there is a coherent strategy to raise the income of the poor to enable them to exit from the poverty trap. Creating productive employment and income opportunities is the most sustainable way of addressing the poverty challenge, with elements relating to enhancing access to better health, education, water supply, finance and infrastructure playing a far more central role than subsidizing consumption of any single goods or services.

Even so, depending upon the importance of a good or service in the consumption basket of a poor household, one could argue for a targeted subsidy to protect the real income of the poor. However, more detailed analysis would be necessary to determine the amount of subsidy to offset the impact of oil price increases on the poor. Implementing such a targeted subsidy will also require an adequate mechanism to identify the poor and ensure that most of the benefits accrue to them. This approach would be more cost effective than a generalized subsidy for oil that is likely to be regressive in the sense that much of the benefit is likely to accrue to the non-poor. And if this generalized subsidy is financed through deficit financing from the banking sector that leads to inflation or by reducing spending on health, education and water supply, it is likely that on the whole the poor will be worse off from this policy packet.

CONCLUDED

The author is the Sector Director for Poverty Reduction and Economic Management in the South Asia Region of the World Bank. The views expressed herein are those of the author and not necessarily those of the World Bank Group.

STOCK