

Chapter 2

The Starting Point

2.1 The developing world started the 1990s against a backdrop of change that is likely to have a significant impact on the development process. But it also started the decade with problems of economic weakness and vulnerability flowing directly from the events of the 1980s.

The 1980s

2.2 The 1980s began with recession in the world economy. Growth was soon resumed in the developed countries and, overall, output in these countries grew on average by 3.1 per cent per year during that decade (see Table 2.1 overleaf).

2.3 In the developing world also, some countries achieved impressive economic growth during the 1980s. Output rose on average by 7.9 per cent per year in East Asia, and 5.3 per cent in South Asia. But growth was limited to a few countries. A dozen or so countries, populous ones such as China, India and Indonesia among them, experienced a significant increase in per capita incomes in the 1980s. But elsewhere the growth in output generally failed to keep pace with population growth, and per capita incomes fell. In 54 out of the 84 developing countries whose economic performance was monitored by the UN Department of International Economic and Social Affairs, per capita incomes fell in the 1980s; in 14, per capita incomes fell by over 35 per cent. Despite a few significant exceptions, in most countries of sub-Saharan Africa living standards fell to levels last seen in the 1960s; and those of millions of people in Latin America and the Caribbean are now lower than in the early 1970s. There was also continuing profound poverty in countries where per capita incomes grew (e.g. India, Bangladesh).

2.4 The seeds of this setback lay in the imbalances that emerged in the 1970s following the two oil price surges, and the build up of inflationary pressures in the developed countries. In the wake of the second oil price rise, the decision by major industrial countries, particularly the United States, to tighten monetary policy sharply as a means of fighting inflation pushed international interest rates sharply upward. (Dollar interest rates rose from 8.7 per cent in 1978 to 16.5 per cent in 1981.) This

Table 2.1
Real GDP Growth Prospects

	Real GDP Growth Rates			Real GDP Per Capita Growth Rates		
	1965-80	1980-89	1990-2000*	1965-80	1980-89	1990-2000*
Industrial countries	3.7	3.1	2.9	2.8	2.6	2.5
Developing countries	5.8	4.0	4.9	3.3	1.9	2.9
Sub-Saharan Africa	4.3	1.8	3.2	1.5	-1.4	0.5
Excluding Nigeria	3.9	2.4	3.3	1.0	-0.8	0.4
East Asia	7.3	7.9	6.7	5.0	6.4	5.3
Excluding China	7.7	6.4	6.8	5.1	4.3	5.2
South Asia	3.7	5.3	4.7	1.2	3.0	2.6
Excluding India	3.9	4.6	4.8	1.2	1.8	2.1
Eastern Europe	5.2	1.4	2.7	4.4	0.8	2.3
Middle East, North Africa & other Europe	6.3	3.5	4.0	3.9	1.0	1.7
Latin America & the Caribbean	6.1	1.7	3.8	3.4	-0.4	2.0
Excluding Brazil	4.7	0.8	3.9	2.0	-1.3	2.0
Memorandum						
Asian NIEa	9.7	8.6	6.4	7.5	7.1	5.5

* Forecast

a Includes Hong Kong, Korea, Singapore, and Taiwan (China).

Note: Aggregated using constant 1987 prices and exchange rates.

Source: World Bank, 'The Developing Countries and Global Economic Prospects, 1991'.

has had manifold consequences. Industrial country output and world trade stagnated and volumes shrank in 1982. The developing countries were suddenly confronted with an unprecedented deterioration in their economic environment: between 1980 and 1982, commodity prices fell by a quarter and export earnings collapsed by \$ 100 billion (in current prices); and on top of this, the rise in interest rates increased the debt service burdens sharply. These events were to result in waning confidence among commercial creditors, whose reduction in lending precipitated the debt crisis.

2.5 Since then the external economic environment has remained unpropitious for the majority of developing countries. Interest rates continued to remain high, and by 1986 commodity prices, in real terms, fell to their lowest level since the Great Depression of the 1930s. Debt became a major obstacle to economic growth. Private flows fell sharply, with many countries experiencing net outflows. The need to service large amounts of debt, weak economic structures and inappropriate policies exposed many countries to difficulty. They were forced to undertake deflationary adjustments in order to generate the trade surpluses needed to service debt. Many of them experienced capital flight and the emergence of parallel markets in goods and foreign exchange. Per capita import levels fell drastically in many of these countries, further weakening their production base and their capacity for economic recovery and growth.

2.6 By the end of the 1980s, a large number of developing countries were thus caught up in acute economic difficulties. Many had experienced declines in gross investment per capita. Physical and human capital resources had suffered and malnutrition spread. Improvements in indicators such as life expectancy and infant mortality slowed down and in some countries even recorded an absolute deterioration. Educational and health programmes had been adversely affected by economic difficulty and by the need to cut sharply public expenditures as part of adjustment programmes. In some countries, structures of administration and governance, often already weak, had become fragile. While certain developing countries did make great progress during the 1980s, most saw the advances achieved in the 1960s and 1970s slow down or even reversed.

2.7 In some parts of the developing world civil wars and regional conflicts added to economic difficulties. In many areas, settled agriculture became impossible and infrastructure was grievously damaged. Military expenditure consumed an increasing share of public resources. Even if political stability returns, these countries will have to resume the task of development from a much weakened base.

2.8 The adoption and implementation of structural adjustment pro-

grammes by many developing countries in response to the events in the 1980s have not yet succeeded in making them materially stronger. The low level of development itself made it difficult for some of them to exploit the opportunities produced by the liberalised policies; material resources for the additional investment in infrastructure and human resources required to make use of the new opportunities were lacking. Inflation remains a persistent problem. In many countries, acute and increasing poverty and underdevelopment now constitute a major cause of social and political strain, and important obstacles to rational economic management. Business confidence, as viewed by internal and external investors, continues to be weak. External assistance has become crucial to much needed recovery.

Vulnerability

2.9 Despite the adjustment programmes, many developing countries were thus left at the end of the 1980s with a reduced capacity to withstand any further internal or external shocks. The events of the decade reduced the cushion several countries have had to withstand shocks of any kind. A drought now results in famine much more quickly and with greater severity, as countries operate with smaller reserves of food grains, weakened infrastructure, and reduced capacity to import. Marginal changes in external factors such as interest rates or in the price of imported energy or exported commodities now have a more significant impact than they had a decade ago. This increased vulnerability arises not only because of the changed domestic economic circumstances but also because many countries now have less access to external finance to provide cover for problems created by sudden changes in external or domestic circumstances. Because of the absence of cushioning resources, adverse changes in balance of payments now require immediate adjustment. This in turn damages prospects for sustainable economic growth, making it more difficult to achieve stability and confidence. The political and social turbulence that accompanies economic difficulty adds to these countries' vulnerability.

2.10 Although the Gulf crisis was in many senses a one-off event, its consequences came at a time when many developing countries had little capacity to withstand them. By contributing to the recession underway in some developed countries, the crisis further depressed global economic prospects. And it affected many developing countries more directly through higher oil import bills, a narrowing of export markets in the Middle East and loss of remittances from migrant workers. The World Bank estimates that the size of the external shock on all affected countries in 1991 is about \$20 billion. The action taken so far through the international financial institutions has not fully offset these losses.

Bilateral aid has been significant, but very narrowly focused; and it may have been at the cost of some aid diversion (see Annex 2 on pp.150-156).

2.11 With the conclusion of the Gulf War, oil prices have returned to near pre-crisis levels, where they are likely to remain for some time. That has already improved the global economic outlook. But the losses already sustained impose deadweight costs on future economic growth.

Prospects for the 1990s

2.12 Given all these difficulties, the economic prospects for many developing countries in the 1990s are bleak. Even before the Gulf crisis, the World Bank projected, on the basis of best assumptions of policy improvement in industrial and developing countries and greater external assistance, per capita growth for sub-Saharan Africa at only 0.5 per cent per annum and for the severely-indebted middle-income countries at 2.0 per cent. For sub-Saharan Africa, it is expected that in the first half of the decade per capita incomes may remain largely stagnant and that the number of people in absolute poverty would increase further by the year 2000. By the end of the century, per capita incomes would still not have recovered to the levels of the early 1980s. The current downturn in the OECD countries and the effects of the Gulf crisis are likely to make this already grim picture worse. Low economic growth and high interest rates constitute a difficult global environment for development.

2.13 Yet not all is gloom in the developing world. Countries in East and South Asia are projected to increase per capita incomes by a significant margin, albeit at a slower rate than in the 1980s. Some individual countries in other regions are also expected to do well. But despite this favourable outlook for some, the overall prospects are sombre. Large countries such as China and India, and some others, which withstood the crisis in the 1980s and managed to increase per capita incomes, seem now to be less well placed to sustain growth. And there is little evidence to suggest that the large number of developing countries which experienced poor economic growth in the 1980s will do markedly better in the 1990s. The polarisation in growth seems set to continue. There is a danger that immiseration, environmental degradation, acute poverty and famine will increase in many countries and that most will fail to make significant progress towards prosperity. All this is in stark contrast to the industrial countries, which experienced substantial gains in per capita income during the 1980s and are set to experience further growth in the decade ahead. Despite the marked progress made by a few developing countries, in the world as a whole, the rich got richer, while the poor got poorer; and the unfolding prospects for the 1990s do not suggest a reversal of this trend.

2.14 Yet periods of great change present opportunities as well as problems. Governments, bankers and business leaders have innumerable preoccupations as they seek to come to terms with new and unanticipated political and economic issues. There is nevertheless a case for serious reconsideration of the problems and opportunities for development. We consider some specific areas for attention in the following chapters.