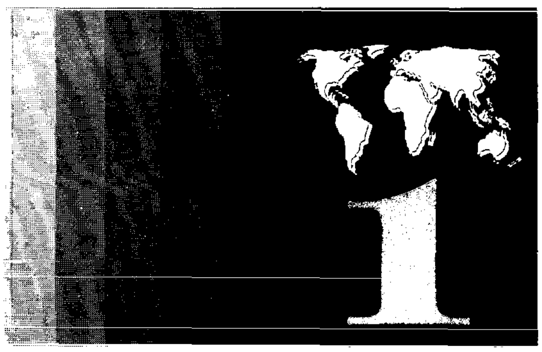


1 Diverging trends in the world economy

Looking back on the 1980s, much of the world can count itself fortunate. One after another, great dangers appeared, only to recede without serious repercussions. The international debt crisis no longer threatens the integrity of the world's financial system; the recession of the early 1980s, which drove unemployment in Europe to record highs, gave way to one of the longest peacetime expansions of this century; the stock market crash of October 1987 failed to cause a second Great Depression. It was a turbulent period, to be sure. But by the standard of the fears expressed at the time, it was a decade of disasters that never happened. Aptly enough, it closed with momentous changes in several Eastern European countries—changes that mark the beginning of a new and uniquely promising era in the history of the world.

Yet millions of the world's most vulnerable people must take a far gloomier view of the past ten years. Many developing countries have not merely failed to keep pace with the industrial countries; they have seen their incomes fall in absolute terms. The living standards of millions in Latin America are now lower than in the early 1970s. In most of Sub-Saharan Africa living standards have fallen to levels last seen in the 1960s. Such facts, extraordinary as they are, fail to capture the plight of the very poorest, whose lives have remained blighted even as incomes elsewhere in the developing world have risen. For many of the world's poor, the 1980s was a "lost decade"—a disaster indeed.

This Report is about the poor. It is thus about the fundamental issue in economic development: the eradication of poverty from the world. Later chapters will look in greater detail at policies that offer hope for reducing poverty. As in previous Reports, however, this first chapter begins by examining recent developments in the world economy and the prospects for the 1990s. Just as the external environment of recent years goes some way toward explaining the disappointing performance of many developing countries, so too the economic outlook describes the foundation on which future efforts to attack poverty will have to be built. It will be far easier to reduce poverty if the platform is one of low inflation, lower real interest rates, and open trade than if fluctuating prices, high real interest rates, and restricted trade prevail. As always, progress in the developing countries is closely bound up with the policies of the industrial countries.

Recent developments in the world economy

The 1980s closed happily for the industrial countries—growth was moderate to high, output was at or near potential, unemployment was well down from the levels seen earlier in the decade, inflation was under control, and world trade was expanding strongly. In the principal industrial countries productivity growth accelerated in the late 1980s, and investment grew nearly twice as fast as GDP. Concern over inflation remained, but restrictive monetary policies appeared to be keeping the pressures in check. Commodity prices were fairly stable, although petroleum prices rose by an average of 20 percent over their 1988 level.

Despite a healthy growth of 3.6 percent in the industrial countries, external imbalances were slow to narrow. The United States finished the year with a current account deficit of $106 billion, down by $20 billion from the previous year. The

Table 1.1 Performance indicators in the world economy, 1989

Group and region	*Real growth of GDP* 1980–89	1989	*Growth of export volume* 1980–89	1989	*Gross domestic investment/GDP*[a] 1980–89	1989
Industrial countries	3.0	3.6	4.8	7.6	20.9	21.5
Developing countries	4.3	3.3	6.1	8.1	24.3	24.6
Sub-Saharan Africa	1.0	3.5	0.0	10.1	16.1	15.2
East Asia	8.4	5.1	14.7	8.1	30.0	30.7
South Asia	5.5	4.8	6.1	9.6	22.3	21.4
Eastern Europe[b]	1.4	0.0	3.8	2.0	29.4	24.8
Middle East, North Africa, and other Europe	2.9	2.5	6.4[b]	1.4[b]	25.9	24.1
Latin America and the Caribbean	1.6	1.5	4.9	4.4	20.1	20.6

a. Data for 1989 are preliminary.
b. Estimates.

Japanese current account surplus fell by more than 27 percent, to $58 billion, but in the Federal Republic of Germany the surplus rose by more than 14 percent, to $56 billion, and approached that of Japan for the first time in recent history. Although concern over the willingness of capital markets to finance the U.S. current account deficit has eased, saving in the United States and other industrial countries remains low. As a result, these economies continue to absorb a large share of the global supply of capital, and this in turn contributes to high world interest rates.

In 1989 the developing countries saw growth slow to 3.3 percent, as against an average for the decade of 4.3 percent (Table 1.1). Growth was strongest in South Asia and East Asia—the regions with the world's largest concentration of poor people—although it was slower in both cases than the average for recent years. Despite strong export performance, South Asia's growth fell to 4.8 percent from 9 percent in 1988. Incomes in East Asia rose by a healthy 5.1 percent, but that followed a 10 percent rise in 1988. China's growth fell to 3.9 percent, less than half the average for the decade, as the pace of economic reform slowed and the government adopted austerity measures to curb inflation by controlling the expansion of domestic credit.

Elsewhere, growth was less buoyant. Real export growth of 10 percent helped boost growth in Sub-Saharan Africa to 3.5 percent in 1989, one of the decade's strongest years. But because population was growing extraordinarily fast, average per capita income scarcely increased. Some countries, including Burkina Faso, Ghana, Mali, and Mauritius, managed growth of more than 5 percent in 1989, but investment remains severely depressed across the region. In some countries investment has fallen to less than 10 percent of GDP—a level that is insufficient even to replace worn-out capital.

In 1989 Latin America saw no recovery from the weak growth and falling per capita incomes that had characterized the rest of the decade. Average income growth was 1.5 percent, but differences within the region were great. Brazil achieved 3.5 percent real growth, whereas the rest of Latin America averaged just 0.2 percent. Debt continues to be a major obstacle to growth: net outward transfers of resources to creditors amounted to almost one-fifth of export revenues. A reappraisal of strategies for handling the debt crisis led to several proposals for a new approach in 1989. The Brady initiative, announced in March 1989, calls for case-by-case debt reduction accompanied by official financial support that is conditional on domestic policy reform. Recognition of the need for debt reduction and for full participation both by official agencies and by private creditors marks an important departure from previous debt strategies.

Several agreements providing for commercial debt reduction have already been concluded under the broad guidelines of the Brady initiative. These agreements, which are backed with financial support from the World Bank, the International Monetary Fund (IMF), and the Japanese government, vary in their structure and terms. Mexico's agreement, for example, covers 85 percent of its commercial bank debt. The Philippines bought back a portion of its commercial bank debt at a 50 percent discount and also received some new loans. Costa Rica's existing commercial bank claims were exchanged for new low-interest bonds. The results so far indicate that in addition to reducing the debt burden these agreements will encourage the countries concerned to strengthen their adjustment pol-

Box 1.1 Reform in the Eastern European economies

The countries of Eastern Europe face the task of transforming their command economies into decentralized and more market-oriented systems. The long-term gains are likely to be great, but in the short term the reformers may face steep transitional costs. Different countries have already adopted their own distinctive approaches. Poland has decided to "cross the chasm in one leap," whereas in Hungary reforms have been more cautious and gradual.

In October 1989 the Polish government announced a far-reaching plan to first stabilize the economy and then move quickly to a market-based system. The goals of stabilization are to reduce inflation—which ran at an annualized rate of 650 percent during 1989—and to eliminate the government deficit. Inflation is to be held down by decreasing real wages, stabilizing food prices, and increasing interest rates to reduce the demand for credit. But these measures will not succeed unless the fiscal deficit is curbed. The plan calls for massive sales of state enterprises, closure of inefficient plants, cuts in price subsidies on food and domestic energy, and cutbacks in spending on defense and public administration. It looks toward an ownership system modeled on that of Western industrial countries. Freedom to establish enterprises is to be codified and restrictions on housing rentals and sales removed. Some of these measures will fall heavily on low-income families and those most dependent on the state.

Hungary's reforms began in 1968, when rigid central planning was abolished and the state began making greater use of taxes, subsidies, and price controls to guide the economy indirectly. During the 1970s and early 1980s progress was slow. In 1985-86, however, new impetus for reform came after the stabilization efforts of 1982-84 had failed to address the underlying structural problems. Wage regulations were made more flexible, enterprises were given greater autonomy in setting prices, and foreign trading rights were expanded. The reforms failed, however, mainly because of lax monetary and fiscal management. Wage increases were allowed to outstrip productivity, and the state incurred large losses. After 1987 the government again tried to impose fiscal and monetary discipline and to stimulate nonruble exports. Although trade performance improved, efforts to curb the fiscal deficit have been disappointing.

The choice of gradual versus rapid reform is also a choice between two sets of risks. Rapid reform is likely to lead to greater dislocation in the short run, whereas slow reform often creates inconsistencies that thwart further progress. In Poland a substantial share of the work force may become unemployed under the planned restructuring and sale of state enterprises. The social safety nets being put in place may prove both costly and inadequate. Hungary took the other path; the government freed many prices and decentralized the economy, but large fiscal deficits led in the end to the failure of the pre-1990 reform efforts.

icies. This should help to restore the confidence of domestic and foreign investors.

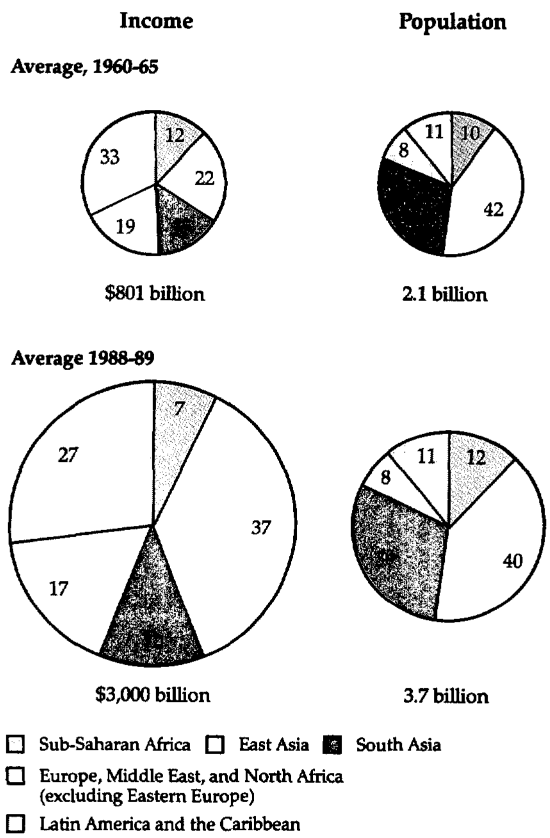
The year 1989 was a historic one for Eastern Europe. Many countries in the region saw nothing less than a political revolution, although a largely peaceful one, and the pace of change in economic policy accelerated everywhere (Box 1.1). Suddenly there has emerged an enormous potential for raising industrial productivity, expanding technological exchange and trade relations, and thereby boosting incomes in the region.

In the short and medium run, however, adjustment will probably involve significant costs. Average regional incomes failed to grow in 1989, and Poland's GDP is estimated to have fallen by 1 percent, with a sharper decrease likely in 1990. Rampant open inflation has occurred recently in Poland and Yugoslavia, but both countries have had early success after implementing tough anti-inflationary policies. Elsewhere in the region there are many signs of repressed inflation.

Expansion of external economic relations may also pose difficulties. More than half the exports of the members of the Council for Mutual Economic Assistance (CMEA)—Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, Romania, and the U.S.S.R.—are within the region. The adoption of outward-oriented market reforms will require restructuring of the CMEA and dismantling of the current accounting practices based on "transferable rubles." Many of these countries' manufactured exports are unlikely to be competitive in outside markets.

In other developing Europe, the Middle East, and North Africa the decade ended with slower growth. On average, income in the region grew by 2.5 percent in 1989, but this implied no growth in per capita incomes. Weak export performance made foreign exchange scarce and curbed investment. Turkey and several countries in North Africa are finding that debt service is absorbing a large share of their export earnings.

Figure 1.1 Changes in the distribution of income and population in the developing world
(percentage share)



Note: Income is in real 1980 dollars.

The diverging performance of developing countries in the 1980s

Over the past quarter-century the distribution of income among the developing countries has changed markedly (Figure 1.1). The East Asian countries account for the largest gain; their share of developing country real incomes rose from 22 to 37 percent. All other regions had lower shares by the 1980s, but Latin America and Sub-Saharan Africa slipped furthest, by 6 and 5 percentage points, respectively. Population shares have also changed over this twenty-five-year period, but much more gradually. Population growth has fallen below average in East Asia, leading to a 2 percent drop in that region's share of the developing world's population, whereas fertility rates in Sub-Saharan Africa are well above average, and the population share is rising. In South Asia fertility rates have been successfully reduced since the 1960s, and income growth has been boosted over the past decade. Although South Asia still harbors the largest number of poor, during the past twenty-five years Sub-Saharan Africa's share of the world's poor has grown and incomes in Latin America have gradually deteriorated.

Why have some regions performed so much better than others? In the end, the battle against poverty depends on the answer to this question. Not surprisingly, trends in poverty during the 1980s reflect trends in overall economic performance. Although data are scarce, the evidence shows that where economic performance was good, poverty decreased. Thus, in Asia poverty declined in India, Indonesia, Malaysia, and Pakistan. In many countries of Sub-Saharan Africa, Latin America, and Eastern Europe, however, external and internal shocks caused poverty to increase. In all the countries in these regions for which data are available—Brazil, Colombia, Costa Rica, Côte d'Ivoire, Poland, Venezuela, and Yugoslavia—poverty increased during at least part of the 1980s.

This performance gap should not be regarded as an unchangeable fact of life; per capita incomes did grow almost everywhere during the 1960s. But the regions began to diverge in the 1970s. By the 1980s per capita GDP was growing at 6.7 percent in East Asia and 3.2 percent in South Asia but was falling in both Sub-Saharan Africa and Latin America (Table 1.2). These regional differences found their counterparts in investment. Both Asian regions increased their national saving and investment rates during these periods, in contrast to the declines experienced in Sub-Saharan Africa and Latin America. Domestic policies and external economic factors combined to determine the levels of regional growth and investment.

Domestic factors: the policy environment

The performance of countries in the 1980s varied according to their initial position and their ability to adjust to shocks over the decade. Many East Asian countries had a relatively healthy balance of payments and strong trade performance at the beginning of the 1980s, and their fiscal expenditures were largely under control. When disturbances such as higher world interest rates came along, these countries responded swiftly and succeeded in maintaining stability and restoring growth. In contrast, many countries in Latin America and Sub-Saharan Africa began the decade with greater

Table 1.2 Performance indicators, by developing region, selected periods

Region	Growth of real per capita GDP (percent)			Gross domestic investment/GDP		
	1965–73	1973–80	1980–89	1965–73	1973–80	1980–89[a]
Sub-Saharan Africa	3.2	0.1	−2.2	16.2	20.8	16.1
East Asia	5.1	4.7	6.7	24.2	29.7	30.0
South Asia	1.2	1.7	3.2	17.1	19.9	22.3
Eastern Europe[b]	4.8	5.3	0.8	28.3	33.8	29.4
Middle East, North Africa and other Europe	5.5	2.1	0.8	23.4	29.2	25.9
Latin America and the Caribbean	3.7	2.6	−0.6	20.7	23.9	20.1

a. Data for 1989 are preliminary.
b. Estimates.

underlying imbalances, often hidden because borrowing had temporarily maintained growth. This group found it much harder to adjust to the shocks of the 1980s.

Successful adjustment requires macroeconomic stability: a low and sustainable rate of inflation, a realistic exchange rate, and a manageable level of fiscal expenditures. It also requires a microeconomic environment that is favorable to new investment. The countries that succeeded in both respects were able to sustain or improve their growth performance during the 1980s.

RESTORING STABILITY. The shocks to interest rates and terms of trade of the 1980s reduced real incomes in most developing countries. Adjustment called for cuts in consumption and in government spending. Countries that were particularly dependent on primary exports or were heavily burdened with debt needed to make even deeper cuts. By and large, the countries that weathered the storm were the ones that acted early. Indonesia, for example, saw its terms of trade decline by 25 percent in 1986; meanwhile, exchange rate movements pushed its ratio of debt to gross national product (GNP) to twice that of Brazil. The government acted promptly by devaluing the rupiah and cutting public spending. The 1986 budget deficit was held to 3.6 percent of GDP despite lost oil revenues; the 1987 deficit fell to just 1 percent of GDP. In both years real GDP growth remained above 3 percent, and it has been even stronger since then.

Government deficits, inflation, and unstable exchange rates are closely related in debtor countries. Large government deficits in the late 1970s and early 1980s were financed mainly by external borrowing. With the halt in foreign loans in the 1980s many governments, particularly in Latin America, increasingly financed their deficits by borrowing at home and by printing money. On average, inflation in the severely indebted middle-income countries was more than 100 percent between 1980 and 1987, compared with 8 percent in South Asia and 5 percent in East Asia.

The recurrent bouts of high inflation that have plagued Latin America are linked to the tax base, the social structure, and domestic politics (Box 1.2). Severe inflation cripples the economy and deepens economic crises in several ways: it undermines domestic confidence, reduces investment, provokes capital flight, and often leads to a misallocation of scarce foreign exchange. It further encourages dollarization (the use of foreign currency as a medium of exchange), and it shrinks the tax base by driving many economic activities into the informal and illegal sectors. The result is an economy that does not respond to adjustment efforts.

RESTRUCTURING FOR GROWTH. For countries that entered the 1980s with structural problems, raising long-run growth requires adjustment policies aimed at institutional reform and reallocation of resources. Unlike stabilization measures, which often hinge on quick and decisive adjustment, economic restructuring also requires long-term planning. The trade regime, the financial sector, and the domestic regulatory framework are all crucial to this task.

The successful East Asian countries have acted swiftly to stabilize their economies while pursuing gradual reform programs and maintaining a competitive exchange rate. The Republic of Korea, for example, pursued gradual but comprehensive trade reform during the late 1970s and 1980s. Indonesia supported its careful approach toward stable exchange rate management with reforms of the trade regime, the domestic regulatory framework, and the financial system. By contrast, most Latin American and Sub-Saharan African countries entered the decade with overvalued exchange rates

Box 1.2 Politics and economic performance

Several Latin American countries have gone through periods of intense political and economic change driven by a combination of social and redistributive goals, populist politics, and nationalism. Although the policies may come from the left or the right of the political spectrum, they and their consequences share remarkable similarities. Examples include Argentina (1946–49), Brazil (1985–88), Chile (1970–73), and Peru (1985–88). Ironically, the very people these programs set out to help have often been harmed in the process.

In each case the government looked for support to a diversity of groups, especially the urban working class and elements of the rural poor. The leaders promised to accelerate and redistribute growth through state activism. Typically, they came to power after a period of slow growth that was often the outcome of previous austerity programs.

The reformist agenda starts with expansionary macroeconomic policies to promote employment and raise real wages. The results are encouraging. In Chile during the first year of the Allende administration GDP increased by nearly 8 percent and real wages rose by 17 percent. Labor's share of national income grew from 52 to 62 percent in that year. In Peru real wages grew by 27 percent in 1986 under the Garcia administration.

In time the program starts to unravel. Stocks are run down, foreign exchange reserves are depleted, inflation increases dramatically, and devaluations become inevitable. An erosion of external support and of access to foreign borrowing generally accompanies these developments. In Brazil in the second year of the Cruzado Plan (named for the new currency introduced in an effort to stabilize the economy) foreign exchange reserves were exhausted, inflation soared to more than 400 percent, and the exchange rate was sharply devalued. In the final stages the program collapses with a surge of inflation, an outflow of capital, and a sharp drop in real wages. In Chile real wages fell by 10 percent in 1972 and by 32 percent in 1973, to well below their preprogram levels. In Peru real wages fell by 34 percent in 1988, and in Brazil they fell by 29 percent during 1987–88.

The programs have generally reduced investment, promoted capital flight, and left workers worse off. They have also had less visible effects—an erosion of investor confidence and loss of government credibility. Later governments are caught in a double bind. Social pressures to restore growth and stability are intensified, and confidence in government is weakened. Under these circumstances it is difficult to halt inflation through currency reform and a fiscal austerity program without a radical change in the policy environment.

that were sustained by high levels of protection and overborrowing. Direct export taxes, nontariff barriers, and quantitative controls on credit and investment were also common. Adjustments were often delayed and hesitant.

Toward the end of the decade many countries in both regions did sharply devalue their currencies and begin substantial reforms of trade and domestic policies. (Some, including Chile, Ghana, and Mexico, were already showing signs of restored growth.) But the response of exports and investment has often been slow. This may be because of continuing uncertainty about the policy regime. Consistent actions are essential to convince the private sector that the policy stance will be maintained. In Sub-Saharan Africa the problems are compounded by the lack of complementary infrastructure, heavy dependence on exports of primary commodities, and weak entrepreneurial and managerial capacity. Adjustment will take longer under these circumstances.

External factors: the global environment

Adverse developments in the world economy also had a part in the falling growth rates of the 1980s. Weak external demand, declining terms of trade, a diminishing supply of external finance, and a great increase in the volatility of interest rates combined to produce an unusually adverse economic climate.

World demand and trade. Growth in the output and exports of developing countries is closely correlated with demand in the industrial countries (Figure 1.2). During the early 1980s growth in developing countries' exports fell as world growth slowed and industrial countries' imports stagnated. Matters have improved somewhat since 1983; the industrial countries have achieved an average GDP growth of 3.5 percent a year, and the volume of merchandise exports from developing countries has expanded by 6.7 percent a year.

Imported primary commodities from developing countries are used mainly as intermediate inputs; here the link to industrial country production is direct. Demand for developing countries' manufactures is also related to industrial country production and to changes in the pattern of final demand. Between 1965 and 1988 the share of manufactured goods in total developing country

Figure 1.2 Growth of OECD industrial production and developing country exports, 1970 to 1989

exports increased from 16 to 64 percent. The growing importance of manufactures—notably, electronics, apparel, toys, and other consumer goods—has strengthened the link between industrial countries and East Asian exporters, in particular. The revival in world demand after 1985 had a smaller effect on the exports of other regions. Exports from South Asia have expanded rapidly since 1985 but remain a low share of national output. Latin America's exports have expanded slowly and have only recently regained the level of the early 1970s. Sub-Saharan Africa's exports fell in the early part of the decade and stagnated through 1988 (Figure 1.3).

Many highly indebted developing countries have been running substantial trade surpluses, largely because of their need to service debt. Between 1980 and 1981 the nineteen severely indebted middle-income countries had an average trade deficit of $4 billion; during 1982–89 they achieved an average annual surplus of $26 billion, the equivalent of 3.3 percent of GDP (see Figure 1.4). This improvement has come largely through a reduction in imports. It bears witness to the squeeze on investment and consumption caused by the austerity programs undertaken in many of these countries. Unfortunately, however, the decline in imported intermediate and investment goods has had adverse long-term effects.

External terms of trade. For many of the poorest developing countries the purchasing power of exports depends on the prices of a few primary commodities—cocoa beans in Ghana, copper and coffee in Papua New Guinea, and so on—in relation to the prices of imports, which are mainly manufactured goods. Prices for primary commodities, especially tropical products and food crops, fluctuate sharply with global supply and demand. During the 1980s prices for many primary commodities fell to their lowest levels since World War II. Nonoil commodity prices declined for most of the decade, although they recovered a little in 1988. By 1989 average commodity prices were still 33 percent lower than in 1980. Oil prices also fell steadily between 1980 and 1985, but most developing countries import oil, and so they benefited.

The decline in the terms of trade during the 1980s has been most pronounced in Sub-Saharan Africa and Latin America, although by the standards of the 1970s both regions started the decade in a favorable position (Figure 1.5). The fall in prices during the 1980s cost Latin America and Sub-Saharan Africa 13 and 15 percent, respectively, of their exports' real import purchasing power relative to the 1970s. In both regions

Figure 1.3 Real export performance of developing countries, 1980 to 1989

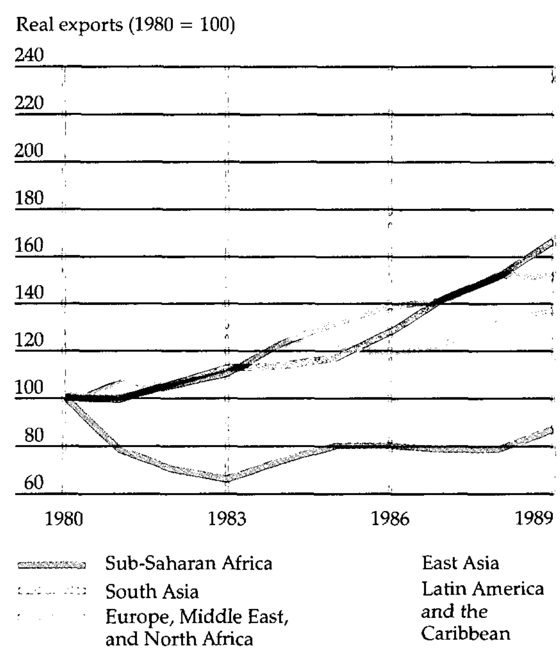
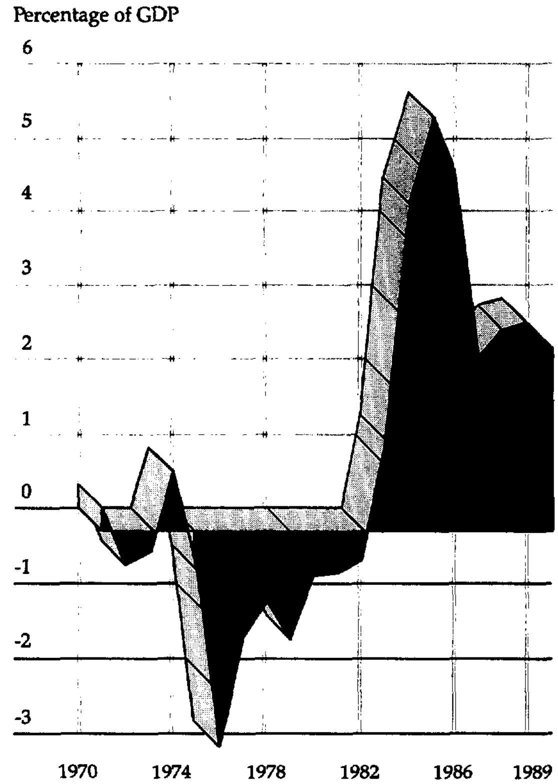


Figure 1.4 Trade balance as share of GDP in severely indebted middle-income countries, 1970 to 1989



roughly two-fifths of this loss was attributable to the effect of lower petroleum prices on oil exporters. Losses elsewhere were much less pronounced.

External finance. Debt can safely be used to finance investment only if the investment generates the revenues that will be needed to repay the loan. The debt accumulated by many developing countries in the 1970s and early 1980s failed this test—although this was partly because of unforeseeable circumstances. The international financial markets responded by halting most voluntary lending to the principal debtors after 1983. The threat of default kept banks from withholding finance altogether, but most of the loans went toward rolling over the debt and capitalizing interest payments in arrears.

Until 1983 Latin America regularly experienced a positive net transfer of long-term debt (excluding IMF credit): borrowing outpaced total debt repayments. After 1984 this changed dramatically. Between 1984 and 1989 total net transfers were −$153 billion, bringing the average annual flow to −$25 billion, or about 15 percent of the region's exports. The halt in commercial lending coincided with, and was partly provoked by, falling terms of trade and rising real interest rates—both of which pushed up the need for financing. Official lending was also scaled back, compounding the difficulties. Some countries in East Asia also found themselves deep in debt in the early 1980s, but they have coped more easily with the problem. Strong current account surpluses have reduced the region's borrowing needs, and the corresponding capital outflow has in some cases taken the form of accelerated amortization payments.

In Sub-Saharan Africa the story is very different. Commercial borrowing has been a significant source of funds only for a handful of middle-income or resource-rich countries. Between 1984 and 1989 only 6 percent of net flows came from private sources. As a result, more than 65 percent of the stock of foreign debt in the region is official,

Figure 1.5 Changes in the terms of trade, by developing region, 1980 to 1988

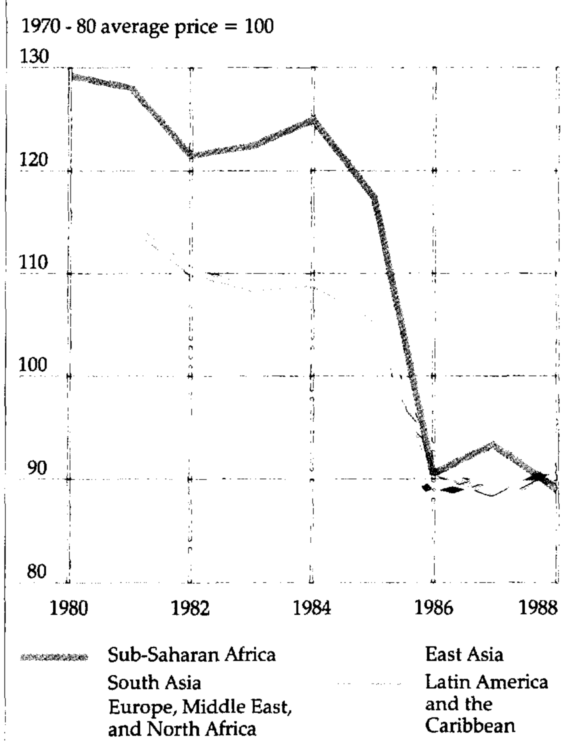
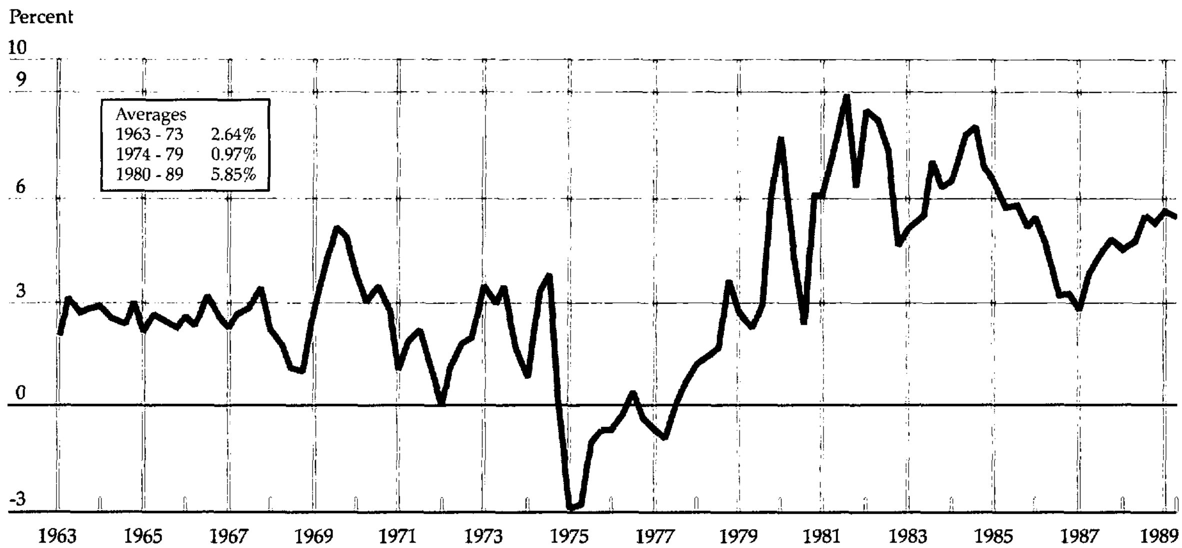


Figure 1.6 Real interest rates, 1963 to 1989



Note: The real interest rate is calculated as the London interbank offered rate (LIBOR) minus the U.S. GDP deflator.

and in 1988 more than half of this was concessional. Although debt remains a serious obstacle to growth, the region has continued to receive large amounts of aid, and net transfers remained positive through the 1980s. The structure of South Asian debt resembles that of Sub-Saharan Africa, but the region's high ratios of debt service to exports have been manageable thanks to relatively strong growth and prudent borrowing.

INTEREST RATE VARIABILITY. Floating rate debt became commonplace during the high-inflation years of the mid-1970s. As long as real interest rates remain constant, floating rate debt should impose no additional burden on debtors. It was the combination of world recession, worsening terms of trade, and a rise in real interest rates that brought on the debt crisis.

Real interest rates were exceptionally high during the 1980s. On average, they were more than twice as high as in the 1960s and nearly six times higher than in 1974–79, when the developing countries took on a large share of their debt (Figure 1.6). High rates were caused by a decline in industrial country savings, by lack of progress in dealing with global current account imbalances, and by large swings in the major currencies, perhaps accompanied by greater uncertainty regarding future exchange rate movements.

The additional burden of high real interest rates, in relation to their 1963–80 average, was roughly $8 billion a year for Latin America during the 1980s, or close to 1 percent of the region's GDP. Much of the cost was concentrated between 1982 and 1985, after the debt crisis first erupted. In 1984 alone this interest rate shock is estimated to have cost 1.8 percent of Latin America's GDP. The cumulative shock to Sub-Saharan Africa and South Asia was milder—less than one-third of that experienced in Latin America.

Prospects for the 1990s

The interaction of unfavorable external events and inappropriate domestic policies has placed some countries on a persistent downward path. Several of the severely indebted countries have become progressively further removed from normal financial relations. The prospects for these countries depend on credible changes in domestic policy and on a response by the international community that will provide a breathing space for the adjustment process.

If the patterns of regional income growth seen in the 1980s were to be repeated in the 1990s, the results would be disastrous for most of Sub-Saharan Africa as well as for parts of Latin America and South Asia. Sub-Saharan Africa, which today

Table 1.3 Prospects for the 1990s

Group and region	Real GDP growth rates: Trend, 1965–80	Real GDP growth rates: Recent experience, 1980–89	Real GDP growth rates: Forecast, 1989–2000	Real GDP per capita growth rates: Trend, 1965–80	Real GDP per capita growth rates: Recent experience, 1980–89	Real GDP per capita growth rates: Forecast, 1989–2000
Industrial countries	3.7	3.0	3.0	2.8	2.5	2.6
Developing countries	5.9	4.3	5.1	3.4	2.3	3.2
Sub-Saharan Africa	5.2	1.0	3.7	2.0	−2.2	0.5
East Asia	7.3	8.4	6.6	4.8	6.7	5.1
China	6.4	10.1	6.8	4.1	8.7	5.4
Other	8.1	6.4	6.3	5.5	4.2	4.6
South Asia	3.6	5.5	5.1	1.2	3.2	3.2
India	3.6	5.6	5.2	1.2	3.5	3.4
Other	3.9	5.0	4.8	1.2	2.2	2.4
Eastern Europe	5.3[a]	1.4[a]	1.9	4.5[a]	0.8[a]	1.5
Middle East, North Africa, and other Europe	6.3	2.9	4.3	3.9	0.8	2.1
Latin America and the Caribbean	6.0	1.6	4.2	3.4	−0.6	2.3

a. Estimates.

has a population of about 450 million, would have an additional 165 million people, and per capita incomes would be 20 percent lower than today's near-subsistence levels. The countries of Latin America would have an additional 85 million people and average incomes 6 percent lower than today's.

The outlook, however, is for stronger performance during the 1990s (Table 1.3). The developing countries should grow, on average, by 5.1 percent a year, compared with 4.3 percent in the 1980s. This judgment reflects confidence that a combination of improvements in domestic policy and greater external assistance will gradually bring growth to closer to its long-run potential by the end of the decade. The disturbances of the 1980s are assumed not to recur, although the process of recovery will be gradual. Real commodity prices are expected to dip in the short run but then rise gradually and grow at an average 0.2 percent over the decade. Real interest rates should ease to between 3 and 4 percent over the decade, as against an average of nearly 5.5 percent in the 1980s.

The industrial countries should grow at roughly 3 percent a year—close to their long-run potential. This outlook takes into account the high rates of investment achieved since the mid-1980s and the productivity growth evident in several countries. In the short run, growth in the United States is projected to slow to between 2.0 and 2.5 percent owing to a decrease in private and government aggregate demand. The U.S. current account deficit will remain below 2 percent of GDP in the early 1990s, but smooth financing of the deficit should prevent any disruption of global financial markets. Over the course of the decade lower U.S. government spending (especially on defense), a gradual depreciation of the dollar, and buoyant growth in the other industrial countries should help to correct the U.S. fiscal and current account deficits.

International political developments should make deficit correction in the United States easier and help to spur more vigorous growth in Europe. The strategic arms negotiations between the Warsaw Pact countries and the members of the North Atlantic Treaty Organization, as well as unilateral decisions by the U.S.S.R. and the United States to pare defense expenditures, will release resources for other uses (Box 1.3). (The members of the Warsaw Pact are Bulgaria, Czechoslovakia, the German Democratic Republic, Hungary, Poland, Romania, and the U.S.S.R.)

Despite this generally favorable outlook, the legacy of the 1980s remains evident. Although all regions are expected to have positive per capita income growth, Latin America and Sub-Saharan Africa are unlikely to achieve their long-run potential. With the reduction of debt under the Brady initiative, per capita income growth in Latin America might rise to 2.3 percent, as against an average of 3.4 percent a year between 1965 and 1980. If this projection is correct, the number of poor people in Latin America is unlikely to decrease during the decade. In Sub-Saharan Africa per capita incomes are not likely to rise in the first half of the decade, although growth of about 1 percent a year is forecast for 1995–2000. The combination of low income growth and high fertility rates implies that the

Box 1.3 World military expenditures in the 1990s

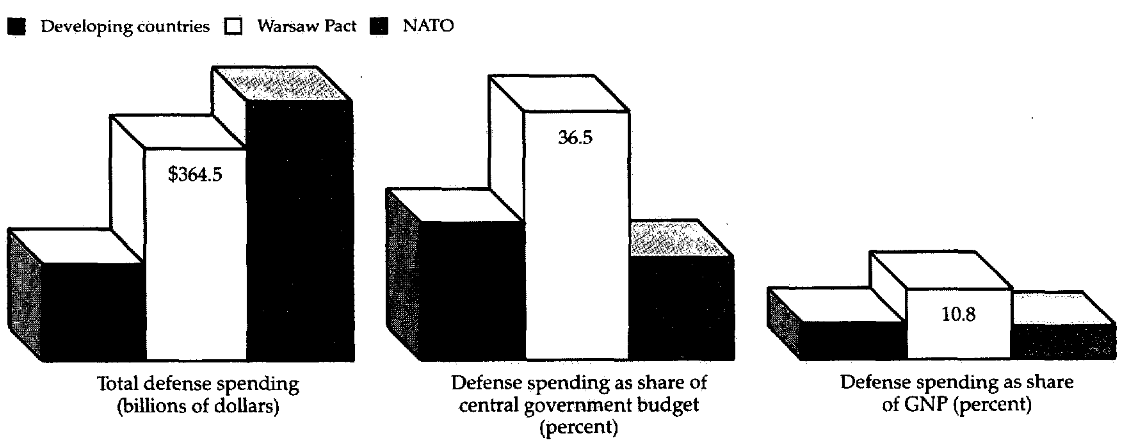
In the 1980s world military expenditures grew to unprecedented peacetime levels; at an estimated $1 trillion (Box figure 1.3), they accounted for roughly 5 percent of total world income. (Owing to data imperfections and methodological differences, estimates vary from source to source. The numbers shown here are given only as an example of the potential benefits from reductions in military spending.) But the decade that began with accelerated spending has ended with the promise of a sharp decrease. In 1989 defense expenditures in the U.S.S.R. fell by an estimated $20 billion, or 6 percent of the defense budget. The United States is also scaling back defense spending, perhaps by as much as 10 percent over the next four years. Much deeper cuts may be feasible.

Success hinges on the Strategic Arms Reduction Talks and the Negotiations on Conventional Armed Forces in Europe. These talks seek to establish an acceptable parity in strategic and conventional forces between the Warsaw Pact countries and the countries of the North Atlantic Treaty Organization. Some analysts estimate that by the end of the decade defense outlays could be brought to half their current levels without jeopardizing the military balance between the superpowers.

The net impact of reduced defense costs on industrial and developing countries will depend on how the "peace dividend" is used. In the United States a conservative estimate puts annual savings over the next four years at about $45 billion, roughly three times the total spent each year on foreign assistance. These resources could be used to cut the fiscal deficit, boost spending on domestic programs, assist industries affected by the cutbacks, or expand the U.S. commitment to development assistance abroad.

Reining in defense spending in developing countries should also be a priority over the coming decade. On average, defense accounts for one-fifth of government spending. Moreover, the high import content of defense expenditures exacerbates the balance of payments difficulties and foreign exchange constraints faced by many developing countries.

Box figure 1.3 Defense expenditures, 1987



Note: NATO, North Atlantic Treaty Organization.
Source: U.S. Arms Control and Disarmament Agency 1988.

number of poor in the region is likely to swell rapidly.

Even this grim prospect assumes that Sub-Saharan Africa perseveres with adjustment and continues to receive debt relief and financial aid. As discussed in detail in a recent World Bank report (*Sub-Saharan Africa: From Crisis to Sustainable Growth*), the region will need to sustain and deepen reforms to rationalize the incentive system, develop domestic infrastructure, diversify the productive base, and improve the efficiency of investment. If this can be done, export volume could grow at about 3 percent a year over the decade, allowing the region to increase imports commensurately while raising the share of investment in national expenditure. The projection also assumes the reduction or rescheduling of all official bilateral debt falling due over the decade, in accordance with the terms adopted by the Group of Seven (G-7) countries in 1988. (The Toronto summit laid out terms for rescheduling concessional bilateral claims and partially reducing nonconcessional bilateral claims on low-income African countries that are following adjustment policies supported by the World Bank or the IMF.) The gains from this assistance are projected to amount to only 10 percent of the countries' current long-term nonconcessional debt by the end of the decade. Clearly, the plan will not relieve the region of its debt burden, but it will ease the financial strain of debt service.

The projected per capita growth of 2.3 percent a year in Latin America will also depend on further policy reform and a significantly lighter debt service burden. The projections assume lower interest rates and buoyant exports (growth in volume of 4.9 percent a year). They also assume a restoration of creditworthiness and a return to precrisis investment levels by the middle of the decade. The current debt reduction strategies will need to be strengthened to ensure sufficient financing for new investment.

For other developing regions the outlook is more favorable. Per capita incomes in South Asia appear set to continue growing at 3.2 percent a year—nearly three times as fast as between 1965 and 1980. India, in particular, is forecast to lead the region with a 3.4 percent growth in per capita GDP—enough to allow substantial progress in reducing poverty. A critical assumption in the projection for India, however, is that the policies that allowed investment, productivity, and exports to expand rapidly in the 1980s will be maintained. With careful management of the real exchange rate, export volume could grow at a robust 8 percent a year. If measures are taken to restrain the fiscal deficit, this rise should prevent debt service costs from undermining growth.

The countries of East Asia are expected to continue the prudent and flexible macroeconomic policies that have worked so well in the past. The region's real per capita income is projected to grow at 5.1 percent a year. This would mean that average incomes would rise by a further 65 percent by 2000 and that poverty would be nearly eliminated. Strong global demand for the region's exports, particularly in Japan, will help to offset the effects of a slackening U.S. domestic market. Manufactured exports from China and Indonesia are expected to expand by more than 9 percent in real terms during the decade. In the high- and middle-income countries of the region exports will matter less for growth as rising domestic demand assumes greater importance.

China's economy is projected to perform well, although growth of per capita income is expected to fall from the 8.7 percent a year achieved in the 1980s to about 5.4 percent. Austerity measures designed to restrain domestic inflation and rein in foreign and domestic borrowing will put a brake on growth early in the decade. Continuing reforms in pricing and labor markets and further decentralization of investment and management should help to bring about sustained advances in productivity.

Considerable uncertainty surrounds the outlook for Eastern Europe. Needed economic reforms, combined with strong anti-inflationary measures, will depress growth for a time despite generous external assistance. Dismantling worker-managed firms and privatizing state enterprises will create open unemployment on a large scale. In the medium run, however, the prospects for boosting productivity and attracting new investment from Western Europe are good. By the end of the decade growth should be robust, and over the decade as a whole per capita income is expected to grow by 1.5 percent a year.

Per capita GDP in other developing Europe, the Middle East, and North Africa is expected to increase at 2.1 percent a year. Thanks to steady growth in world demand for oil and to an expected decline in the share of output from countries that are not members of the Organization of Petroleum Exporting Countries (OPEC), oil prices are forecast to rise 3 percent a year in real terms. This will strengthen the region's terms of trade. Debt service, however, will continue to be a drain. Morocco is the only North African country with commercial debt big enough to merit consideration for relief under the Brady initiative, but several other countries have debt-to-exports ratios that put them nearly on a par with many of the severely indebted countries.

Risks in the outlook

These forecasts inevitably rest on assumptions that may turn out to be wrong. By modifying some of the assumptions, it is possible to estimate ranges for the forecasts. This exercise also confirms the important influence that fiscal and monetary policies in the industrial countries have on developing countries. The fiscal policies of the United States have particularly large international repercussions because of the country's size and the pivotal role of the dollar in global financial markets. The persistence of current account imbalances among the United States, Japan, and Europe is largely the result of the drop in saving in the United States—a decline for which both the government and households are responsible. Overall savings in the United States have fallen by about 3 percent of GNP since the early 1980s. If savings in the United States and other industrial countries fail to rise as projected—perhaps because the United States fails to cut its federal deficit—then real interest rates will remain high in the 1990s. Under this scenario, and assuming that the industrial countries continue to tighten their monetary policies, industrial country growth rates are likely to be about 0.5 percent lower over the decade, and real interest rates will probably hold steady at about the 1980s average of 5.5 percent.

This situation would damage the growth prospects for developing countries through four main channels. First, slower industrial country growth would dampen import demand for developing country exports. Second, higher real interest rates would increase the debt service burden on countries with floating rate debt and those undertaking new borrowing. Third, commodity prices would be likely to weaken, worsening the terms of trade for exporters of primary commodities. Finally, the slower-growing industrial countries would probably be less generous in their assistance to developing countries.

Developing countries that have heavy commercial debts and depend on exports of primary commodities would be the most vulnerable to this turn of events. Over the decade real income growth in the developing countries as a group would be about 0.7 percent lower than the forecasts presented in Table 1.3. Asia would be least affected since, compared with the group as a whole, the region holds less commercial debt, has a greater share of manufactures in exports, and (except for the export-led countries) is less dependent on trade. Real income growth in South and East Asia would be lower by about 0.6 percent. Latin America would be worst affected; its average real growth would be reduced by about 1.0 percent over the 1990s. In Sub-Saharan Africa a low share of floating rate debt offsets the region's high dependence on commodity exports. As in Asia, income growth would decline by 0.6 percent, but because of the region's growing population, a slowdown there would mean that per capita incomes would fall over the decade. The outlook for the incidence of poverty in Sub-Saharan Africa would worsen accordingly.

Coordination of policies among the principal industrial nations (notably, to stabilize exchange rates) became an important factor in international economic relations during the 1980s. At their annual summits, however, the G-7 countries have as yet failed to give due consideration to the effects of their policies on the developing world. Finding solutions to the problems faced by developing countries, especially those that did not share in growth during the 1980s, will increasingly rest on coordinated efforts that recognize these linkages. There are two tasks of immediate importance: to ease the debt burden on developing countries and to lower barriers to world trade.

Dealing with debt in the 1990s

The goal of the highly indebted countries has not changed: as in the 1980s it is to return to sustained growth and external creditworthiness. That these countries have failed to restore growth and are now more deeply indebted than at the outset is testimony to the difficulty of their task. Since the debt crisis began, many severely indebted countries have restrained imports, raised exports, and thereby generated trade surpluses. These adjustments, however, have been made at the cost of compressed consumption and wages, lower investment and output, and frequent recourse to inflationary financing of government deficits. A strategy is needed to break this pattern in the 1990s.

Among the severely indebted countries a distinction must be made between low- and middle-income countries because of their significant structural differences (Table 1.4). The severely indebted low-income countries—twenty-six in all, most of them in Sub-Saharan Africa—suffer from deeply rooted structural weaknesses. Most have weak financial and infrastructural bases, depend on a narrow range of primary commodities for exports, and are crippled by low nutritional and educational standards. Rapid population growth exacerbates their difficulties. In contrast, the middle-income debtors are well endowed with natural resources and skilled labor and have well-developed industrial bases.

For all the severely indebted countries the main challenge is to design and implement credible policy reforms to foster growth. The direct benefits

Table 1.4 Comparative indicators for severely indebted low- and middle-income countries
(percent, unless otherwise specified)

Indicator	*Low income*	*Middle income*
Average population growth (1988)	3.1	2.0
GNP per capita (1988 dollars)	274.0	1,782.0
Gross domestic investment as a share of GDP (current prices, 1987–88)	14.4	22.4
Exports as a share of GDP (1987–88)	19.4	16.3
Imports as a share of GDP (1987–88)	23.3	13.7
Share of manufacturing in exports (1987–88)	6.2	45.0
Share of nonfuel commodities in exports (1987–88)	52.5	39.3
Official development assistance as a share of GDP (1987)	8.2	0.5
Under 5 mortality rate (per thousand, 1985)	191	84
Primary net enrollment rate (1985)	50	89

Source: World Bank 1989f and World Bank data.

that can be won through negotiations cannot by themselves lift the constraints imposed by chronic indebtedness; they must go hand in hand with the indirect benefits of restored credibility, higher private investment, and the repatriation of flight capital. New measures are needed to encourage investment, improve the allocation of resources, and raise, in a less distortionary way, domestic revenues for financing government. The outlook for growth and renewed creditworthiness would then be bright.

In most cases official creditors account for more than four-fifths of the total debt of the severely indebted low-income countries. The principal creditor governments are trying to reduce the debt burden of this group through the mechanisms agreed to at the 1988 Toronto summit. Sixteen Sub-Saharan African countries have rescheduled under the new protocol. The Special Program for Africa, which provides concessional balance of payments assistance to low-income countries that are undertaking significant reforms, is expected to be extended beyond 1990, when the current program ends. These, together with the IMF's Enhanced Structural Adjustment Facility, are the main sources of multilateral concessional assistance.

Even with favorable commodity prices and export growth over the next decade, the severely indebted low-income countries will need further assistance, including debt reduction, if they are to maintain per capita consumption and increase investment at the same time. They face structural impediments to growth that will take several years to overcome. In the meantime, debt service, even after the Toronto reschedulings, will continue to cost an average of 5 percent of GDP during the 1990s.

The Brady initiative is directed at the nineteen middle-income countries with predominantly commercial debt. In this group the potential for restoring growth is greater. Experience with the Brady initiative so far suggests that it is possible to strengthen adjustment programs and mobilize private investment through partial debt reduction (see Box 1.4). But there is room for improvement. For a variety of reasons, foreign commercial creditors remain reluctant to provide much new lending. Alternative profit opportunities and doubts about the prospects for debt-distressed countries, even with Brady programs in place, have accelerated the exit of commercial banks. Changes in banking regulations in creditor countries could encourage banks to take part in debt reduction programs and grant new loans. The official financial resources available under the Brady initiative amount to $30 billion to $35 billion. This is a significant amount of assistance—enough to reduce the annual debt service of the severely indebted middle-income countries by an estimated $6 billion a year between 1990 and 1993. But it is not enough to support programs for all nineteen Brady countries. Additional financing from bilateral official sources may become necessary.

Insurance against shocks is also likely to be part of any successful strategy. A 10 percent deterioration in the terms of trade, or a 2 percent rise in world interest rates, could erase the gains from debt reduction under the new approach. Protection against such contingencies is needed. One possibility is commodity-linked bonds, which spread the risk between creditors and debtors in the event of a severe drop in commodity prices. Another is to include provisions for severe output price shocks. These provisions might mirror the upside recapture clauses in the recent Mexican agreement and link lower export prices to lower debt repayment.

Policy reform to encourage investment and growth in export industries is an explicit part of the new strategy. Stronger exports would make it eas-

Box 1.4 Mexico's economic prospects after Brady

In January 1990 Mexico became the first country to complete negotiations for debt restructuring under the Brady initiative. The agreement covers $49 billion of commercial loans and, according to some estimates, provides $12 billion in debt relief. Net external transfers—debt service minus new loans—will, on average, be reduced by about $4 billion a year over the next six years. This is equivalent to nearly one-fifth of merchandise exports in 1989.

Success depends on the direct and indirect effects of the agreement on domestic investment and growth. The immediate direct impact is to reduce debt service and thus free resources for other uses. But more important is the indirect effect on investment through the improvement in confidence and financial stability.

The indirect effects can come about in two ways. First, lower debt service implies less dependence on printing money to cover the deficit and hence lower inflation. This should ease expectations of future exchange rate depreciation and help to reduce real domestic interest rates. A rise in the secondary market price for sovereign debt, as happened after the announcement of the Brady plan for Mexico, may also lower domestic interest rates and so promote investment. Second, lower inflation and greater confidence will encourage the repatriation of flight capital. Between 1980 and 1988 an estimated $15 billion to $45 billion left the country through capital flight by private Mexican investors, and only a small part is estimated to have returned.

Without access to external funds, government investment would be severely curtailed, domestic interest rates would have to rise much higher to prevent further capital flight, and private investment would fail to recover. The Brady pact brings Mexico's goal of 5 percent annual growth by 1996 within reach. Achieving it will depend on stringent macroeconomic management, continued progress with the adjustment program, and increasing private investment.

ier to finance imports and service debt and would thereby help to restore creditworthiness. Clearly, however, such export-based growth would be hindered by greater protectionism in the industrial countries. Efforts to improve global trade relations should be seen as an important part of the broader strategy for reducing debt and restoring growth in the middle-income debtor countries.

Changes in the world trade system

During the 1990s developing countries' export volumes are expected to grow at 6 percent a year—the same as during the 1980s. Domestic policy is critical for such growth, but just as essential will be the strengthening of the General Agreement on Tariffs and Trade (GATT) through the Uruguay Round, which is scheduled for completion by the end of 1990.

Although successive GATT rounds have cut industrial country tariffs significantly, the use of nontariff barriers has been on the rise lately. In the United States nontariff barriers on steel, automobiles, and textiles are estimated to be equivalent to an additional tariff of about 25 percent, raising protection to the level of the early postwar years. In 1989 the United States warned Brazil, India, and Japan that it might take unilateral steps to protect trade by using its "Super 301" legislation. Trade frictions with the United States have been reduced through bilateral discussions, but the threat of unilateral action remains. Voluntary export restraints, especially on more sophisticated manufactured goods, have proliferated. More than 120 such restraints affected the exports of developing countries in 1988.

The Uruguay Round offers a chance to create a truly global trade regime under the GATT. The expansion of country and product coverage suggests that new ground may be broken. More countries than ever before are active members of the GATT, and several developing countries that had been nominal signatories are now full partners in the negotiations. The talks are covering virtually every kind of trade—not just conventional merchandise but also agriculture, services, investment measures affecting trade, and intellectual property rights.

Open trade relations are ultimately in everybody's interest. Protection in the industrial countries preserves only a small number of jobs, and at great cost to consumers. In the United States, for example, the cost of protecting each job in the textile industry is roughly four times the annual wage of the average textile employee. Protection in developing countries burdens consumers and industries that need imported inputs, and it creates an environment that rewards inefficiency. Competitive industries—the automobile industry in Korea, for instance, and the production of commuter airplanes in Brazil—have sometimes been built behind protectionist walls, but such success is rare, and failure is all too common.

Box 1.5 Going bananas in the European Community, 1992

World trade in bananas totals about $2 billion a year, and 30 percent of this is sold in the European Community. Although these imports are regulated by the EC, exceptions to existing rules protect the rights of some countries to grant preferential arrangements to traditional suppliers. For example, Italy imports bananas from Somalia and Britain from Jamaica and the Windward Islands. Belgium, Denmark, and Luxembourg have set a flat 20 percent tariff on bananas from other than African and Caribbean countries. Germany, the only country with essentially unrestricted trade, imports mainly from the efficient "dollar banana" countries in Central and South America.

After 1992 a common agreement on banana imports will be in place. It is still unclear what form this agreement will take, but it will have important effects on the division of export earnings among banana producers. Box table 1.5 reports the simulated effects on the banana market of a move to free trade.

Moving to free trade would lower the price that protected exporters receive by 49 percent, and they would suffer a loss of $209 million. Developing country exporters in the dollar banana countries would gain an estimated $61 million from the move to free trade. The largest net gains ($386 million) would go to the Europeans themselves, mainly as a result of the 24 percent drop in import prices. Non-European importers (principally the United States) would lose an estimated $46 million owing to the rise in world prices.

Box table 1.5 The impact on the banana market of moving to free trade in the European Community

Group	*Price effects (percent change)* [a]	*Volume effects (percent change)*	*Revenue effects (millions of dollars)*
Exporters			
Protected [b]	−49	−46	−209
Other suppliers	4	12	61
Importers			
European protected markets [c]	−24	15	394
European unprotected markets [d]	1	1	−8
Rest of world	2	−1	−46

Note: Prices are based on 1987 data.
a. Average retail prices are used for importers and f.o.b. export prices for exporters.
b. Canary Islands, Guadaloupe, Jamaica, Madeira, Martinique, Somalia, the Windward Islands, and other African, Caribbean, and Pacific (ACP) countries. (European imports of bananas from the Pacific states are, however, negligible.)
c. France, Greece, Italy, Portugal, Spain, and the United Kingdom. French prices are used to represent the market.
d. German prices represent the market.
Source: Borrell and Yang 1990.

"Project 1992," the effort to create a single European market, is likely to have a great effect on world trade. The European Community (EC) will become the largest market in the world, with a population of 320 million and a GDP of about $6 trillion. It will account for about 30 percent of developing country exports. And this huge market may well expand during the next decade to include several members of the European Free Trade Association (EFTA) and some Eastern European countries. (Indeed, the German Democratic Republic is already likely to be included.)

The effect on the developing countries will depend on whether the trade-creating effects of greater efficiency and growth outweigh the trade-diverting effects of external barriers to entry. It has been estimated that the 1992 program could boost European GDP by as much as 5 percent in five to ten years, leading to an increase of about $4 billion in imports of primary commodities from developing countries. The EC Commission, however, has estimated that the removal of internal barriers may reduce Europe's manufactured imports by 10 percent, and the developing countries would bear part of that loss of trade. The possibility that trade diversion could outweigh trade creation is greater for manufactures, especially if the gains in EC output come about through trade diversion rather than as a result of higher productivity. The net impact on the main developing country exporters to Europe might then be severe. This risk would increase still further if the EC adopted special trade arrangements with Eastern Europe; other developing countries compete with Eastern Europe in supplying manufactured goods to European markets.

Much depends on what form Europe's common external trade barriers take. Will Europe remove its trade restrictions and reduce tariffs—perhaps as part of the Uruguay Round (Box 1.5)? Or will it replace trade restrictions with tariffs or adopt other nontariff barriers, such as uniform quality standards and content requirements? All developing country exports—tropical and temperate agricultural goods, manufactures, and services—will be affected directly and indirectly by these decisions. The greatest threat is that new trade barriers will proliferate, encouraging retaliation elsewhere.

What does this mean for the poor?

The aggregate statistics examined in this chapter are important for understanding events in the world economy, but they do not show what is happening to people, especially the poor. The rest of the Report addresses this question directly. How the poor earn their living, the adequacy of their health care, and their access to education and other public services will be examined in detail. But this chapter's findings concerning the differences in regional economic performance are immediately relevant. Although growth in average per capita incomes does not automatically improve the well-being of the poor, it is a crucial factor. Figure 1.7 shows sharp regional differences in recent and forecast income growth. What do these differences mean for the poor?

The next two chapters examine the current extent of poverty and the consequences for the poor of recent economic performance. Has rapid per capita growth in East and South Asia really reached the poor? Who suffers most from falling incomes in Sub-Saharan Africa? Chapters 2 and 3 lay the foundation for the discussion of public policies in Chapters 4 through 8. The final chapter reexamines the implications of the divergent regional performances projected for the 1990s and asks how they will affect the outlook for reducing global poverty at the start of the next century.

Figure 1.7 Real per capita growth in developing countries in the 1980s and forecast values, 1990 to 2000
(percent)