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## Prospects for Developing Countries and World Trade

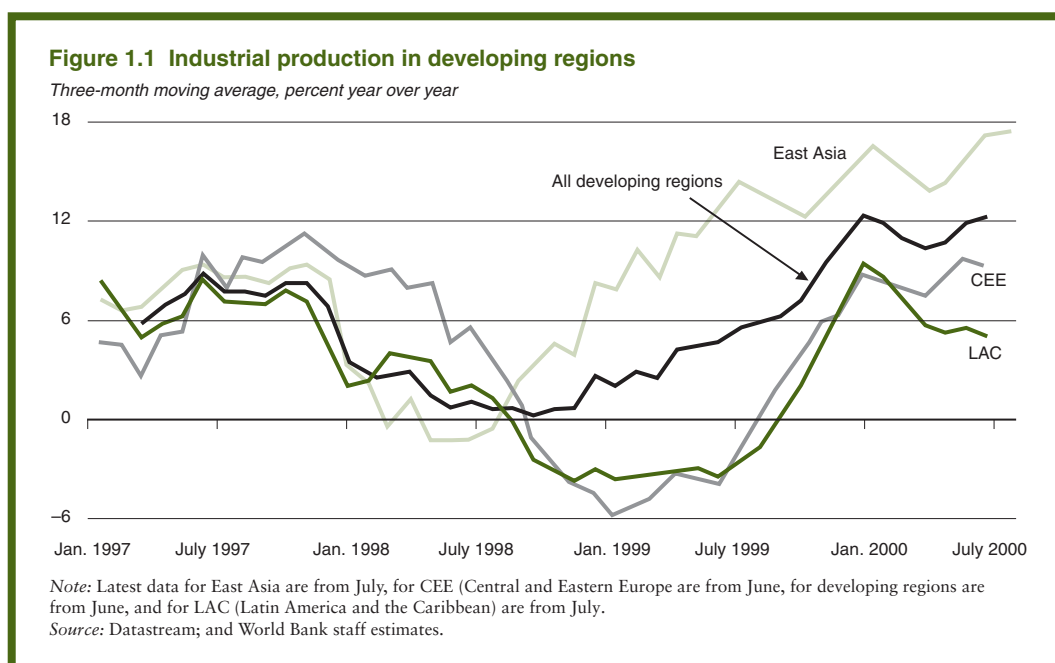
**W**ORLD ECONOMIC ACTIVITY DURING 2000 is proceeding at the fastest pace in over a decade, with developing-country output growth expected to exceed 5 percent. World trade volumes are expected to rise by a record 12.5 percent in the year. Although oil prices have surged by more than 50 percent, inflation in both industrial and developing countries continues, thus far, to be relatively subdued. But developments in oil markets remain a major uncertainty in the outlook, as do the sustainability of the remarkable non-inflationary U.S. expansion and the general fragility of financial systems in East Asia. This chapter reviews the cyclical and structural factors responsible for the robust economic expansion and discusses the major challenges and risks ahead, in both the short and the medium terms. The main conclusions are:

*The world economy recovered remarkably well and is likely approaching a cyclical high in 2000*

Many of the developing countries that experienced a sharp rebound after the 1997–98 recession appear to have reached cyclical peaks, with the five East Asian countries hit hardest by the financial crisis the clearest example of this development (figure 1.1). The strength of the recovery in Latin America has been impressive, but momentum appeared to be waning in the second half of the year. And the rebound in the Russian Federation has also been unexpectedly strong, though largely dependent

on high oil revenues and more fragile than in East Asia. With oil prices expected to ease in the medium term and the effect of the 1998 ruble devaluation wearing off, the Russian Federation's current GDP growth of about 7.2 percent is expected to slow significantly over the medium term. Sub-Saharan Africa has experienced a less uniform recovery, with oil exporters gaining and commodity dependent oil-importing nations suffering large terms-of-trade losses. These synchronous recoveries have carried developing-country growth to a peak of 5.3 percent in 2000—0.7 percentage points faster than projected nine months ago in the World Bank's *Global Development Finance 2000*—with a slight slowing to 5.0 percent expected next year (table 1.1). Growth in the industrial countries may also be nearing a turning point; it is expected to slow from this year's rapid 3.7 percent pace to 2.9 percent in 2001. Moderation of consumer demand in the United States, following interest rate increases and stock market declines, is the principal factor behind this modest deceleration.

The current double-digit growth of world trade, the strongest since before the first oil shock of the early 1970s, is clearly a cyclical phenomenon tied to robust world activity levels. During the upswing, as inventories were replenished and investments accelerated, trade expanded much faster than the economy as a whole. Once stocks of durable goods and capital goods have adjusted, growth rates of trade



should moderate to around 8 percent, which is still a high level by historical standards.

***Foundations for longer-term growth have improved in many industrial and developing regions . . .***

Industrial countries have been undergoing a period of accelerated transformation, restructuring, and adjustment that is now starting to pay off. The United States appears to have created an institutional and policy environment that supports the adoption of new information and communications technologies at a rapid pace, contributing to a substantial acceleration in productivity growth. Most European countries have made some progress in rendering labor markets more flexible and exposing product and service markets to greater competition; these processes have been facilitated by regional integration, including, most recently, the introduction of a single currency. The recent decline in Euro Area unemployment rates, and the more than doubled value of merger and acquisitions (M&A) activities and corporate bond issues in 1999, offers some

indication of accelerated restructuring and improved business confidence. And Japan appears to be emerging from a long period of sluggish growth. This follows the initiation of serious efforts toward financial and corporate restructuring, although a lack of self-sustaining effective demand, especially from private consumers, is still a danger.

Liberalization, accompanying policy measures, and technological change in many developing countries have led to a spectacular increase in openness during the 1990s. Foreign direct investment (FDI) flows into developing countries rose from 0.5 percent of developing countries' GDP in 1990 to 2.7 percent at the end of the decade. Despite the financial crisis, exports of goods and services from developing countries increased by 10 percent a year during the 1990s, contrasted with less than 4 percent during the 1980s. Competition from both domestic and foreign sources has increased in this more open environment, and macroeconomic policies have become more prudent, keeping inflation low and reducing some of the larger fiscal deficits. And indicators of human capital,

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**Table 1.1 Global conditions affecting growth in developing countries and world GDP growth**  
(percentage change from previous year, except interest rates and oil price)

	Current Estimate	Current Forecasts			March 2000 Forecasts		
	1999	2000	2001	2002	2000	2001	2002
<b>Global Conditions</b>							
World trade (volume)	5.8	12.5	8.0	6.8	8.3	6.9	6.5
<b>Inflation (consumer prices)</b>							
G-7 OECD countries <sup>a,b</sup>	1.2	2.0	1.9	1.9	1.8	1.9	2.0
United States	2.2	3.4	3.0	2.8	2.7	2.5	2.6
<b>Commodity prices (nominal \$)</b>							
Commodity prices, except oil (\$)	-11.2	-0.8	3.4	4.9	5.6	3.9	3.3
Oil price (\$, weighted average), \$/bbl	18.1	28.0	25.0	21.0	23.0	19.0	18.0
Oil price, Percent Change	38.3	55.0	-10.7	-16.0	27.3	-17.4	-5.3
Manufactures export unit value (\$) <sup>c</sup>	-2.7	-2.3	3.6	3.7	2.5	2.5	2.6
<b>Interest rates</b>							
LIBOR, 6 months (US\$, percent per year)	5.5	6.7	6.8	6.2	6.5	6.5	5.5
EURIBOR, 6 months (Euro, percent per year)	3.0	4.5	5.0	4.6	...	...	...
<b>World GDP growth</b>							
High-income countries	2.7	4.1	3.4	3.2	3.5	3.1	3.1
OECD countries	2.7	3.8	3.0	2.8	3.2	2.7	2.6
United States	2.7	3.7	2.9	2.7	3.0	2.6	2.5
Japan	4.2	5.1	3.2	2.9	3.8	2.7	2.8
Euro Area	0.3	2.0	2.1	2.2	1.2	1.4	1.6
Non-OECD countries	2.4	3.4	3.2	2.8	3.4	3.1	2.8
Developing countries	4.2	6.3	5.1	5.1	4.6	4.8	5.1
East Asia and Pacific	3.2	5.3	5.0	4.8	4.6	4.8	4.8
Europe and Central Asia (ECA)	6.9	7.2	6.4	6.0	6.6	6.3	6.1
Latin America and the Caribbean	1.0	5.2	4.3	3.9	2.5	3.4	3.6
Middle East and North Africa	0.1	4.0	4.1	4.3	3.6	3.8	4.4
South Asia	2.2	3.1	3.8	3.6	3.5	3.6	3.6
Sub-Saharan Africa	5.7	6.0	5.5	5.5	5.9	5.8	5.5
Memorandum items	2.1	2.7	3.4	3.7	3.2	3.7	3.8
East Asian crisis-affected countries <sup>d</sup>	6.7	6.9	5.5	5.1	5.7	5.4	5.1
Transition countries of ECA	2.5	5.0	4.2	3.7	2.1	3.0	3.3
Developing countries							
Excluding the Transition countries	3.3	5.3	5.1	5.0	5.0	5.0	5.1
Excluding China and India	2.2	4.7	4.4	4.3	3.8	4.0	4.2

... Not available.

a. Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

b. In local currency, aggregated using 1995 GDP weights.

c. Unit value index of manufactures exports from G-5 to developing countries, expressed in U.S. dollars.

d. Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.

Source: Development Prospects Group, baseline, October 2000; and GDF projections of March 2000.

including school enrollment and illiteracy rates, have shown broad improvement across most developing regions. With these structural changes, many countries in Latin America, Central Europe, and Sub-Saharan Africa appear to have considerably improved their growth potential. Assuming continued corporate and financial restructuring to deal with the debt overhang left by the crisis, countries in

East Asia should achieve high rates of growth over the next decade.

*... but these favorable cyclical and structural conditions contain built-in tensions*

Developments during the global financial crisis sowed the seeds for some severe imbalances that have remained or become evident during

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the current boom. The adoption of an easier monetary policy in the United States to avert a global recession in late 1998 contributed to an acceleration of U.S. demand growth and a widening of the current account deficit, which is likely to breach 4.5 percent of GDP in 2000. Fiscal stimulus in Japan, while helping to sustain demand during the worst part of the crisis, has further increased the huge burden of government debt to some 115 percent of GDP. Nonperforming loans in the Asian crisis countries reached 30 to 50 percent of GDP and have been declining only gradually. The financial vulnerabilities translated into an average decline of more than 30 percent in the equity markets in these countries between January and November. The strong global recovery of 1999–2000, coupled with the sharp reduction in OPEC supply (following the plunge in oil prices to \$10 per barrel in 1998), caused a surge in oil prices.

Structural reforms and rapid technological change have also generated political tensions. The fast pace of global economic integration has accentuated competition and increased uncertainty, particularly for firms in declining industries and their workers. Inequality, both among and within countries, and in part tied to technological change, appears to have increased. A backlash against globalization could result in a slower pace of reforms, especially if the current expansionary phase is broken.

### *These tensions could reduce growth in both the short and longer terms*

The baseline scenario assumes a soft landing for the U.S. economy, smooth private sector adjustment, and prudent policy reactions to the current oil price shock. However, a less favorable resolution of the tensions now affecting the global economy is possible. Supply interruptions or unexpectedly high demand could lead to a sharper and more protracted spike in oil prices, while uncertainty about future oil prices could severely affect business and consumer confidence. These adverse reactions could be reinforced by a tightening of monetary policies. A reversal of international investment flows to the United States, triggered

by increasing current account deficits and a change in sentiment in the stock market, could accentuate the global downturn affecting East Asia and Latin America more severely. The sharp growth slowdown that would result, coming on the heels of the global financial crisis, may feed “reform fatigue” in developing countries, resulting in low growth. The low-case scenario below illustrates the importance of reducing short-run imbalances to safeguard the long-term prospects for growth.

This chapter is organized as follows. First the cyclical environment and the long-term growth potential in the industrial countries are discussed, and a review of recent developments and prospects for world trade and financial flows to developing countries follows. The section on commodity prices focuses on the sharp hike in oil prices, one of the major threats to the current outlook. And the following two sections summarize the consequences of these trends for developing regions in the short and longer terms, including elaboration of a low-case scenario. Finally, the consequences for poverty alleviation are explored.

### **Long-term growth in industrial countries is projected to be higher**

Growth in the high-income Organisation for Economic Co-operation and Development (OECD) countries may average 3.7 percent in 2000 (the fastest growth recorded in over a decade), driven by a sharp acceleration of exports, strong carryover effects of the U.S. consumer boom of late 1999 to mid-2000, broadening and strengthening of economic activity across the Euro Area, and a pickup in Japanese private and public investment spending. Growth rates in the three major blocs are expected to move toward convergence, yielding OECD growth of 2.9 percent in 2001 and 2.7 percent in 2002 (figure 1.2). But this outlook is subject to important risks, including the potential for a hard landing in the United States because of investor concern over the burgeoning current account deficit, higher inflation and the likelihood of monetary tightening if the present spike in oil

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prices is sustained, and a disruption of the Japanese recovery because of fragile financial conditions.

### *Structural transformation may lead to stronger long-term growth*

Technology-driven productivity growth in the United States, market reforms and adjustment to a common currency in the European Union (EU), and corporate and financial restructuring and deregulation in Japan offer the potential for rapid growth in the long run. However, important challenges remain in reaping the benefits of these new technologies, expanding the EU to the east, and adjusting to slower population growth. Moreover, the huge U.S. external deficit and Japan's rising government debt will continue to pose major risks. Assuming effective policies to confront these challenges, growth for the industrial countries over 2003–10 has been upgraded from earlier forecasts to 2.8 percent.

### *Cyclical and structural forces are shaping the path of U.S. expansion*

**United States.** The remarkable performance of the U.S. economy since the mid-1990s has its roots in prudent monetary, fiscal, and regula-

tory policies that encouraged private sector activity. It also stems from the availability of venture capital and a flexible labor force that facilitated productivity-enhancing innovations in information and communications technology (box 1.1). Nevertheless, cyclical factors have played an important role in the boom. Increasing job opportunities, rising incomes and wealth, and strong corporate profits have boosted consumer and business optimism to record levels and encouraged rapid growth in expenditure. Equity price movements have exerted a large impact on consumer behavior (figure 1.3). Over 1995–98, household net wealth grew each year by some 30 percentage points more than disposable incomes.<sup>1</sup> Partly as a result, the personal saving rate dropped from 7.6 percent in the first half of the 1990s to negative territory (–0.2 percent) in the third quarter of 2000.

Consumer price inflation has risen by 1.5 percentage points over the last year, partly in response to the 50 percent rise in oil price. Compensation pressures are rising, as the Employment Cost Index increased by 4.4 percent during the first three-quarters of the year. However, the pass-through of rising input costs to core inflation has been limited, in

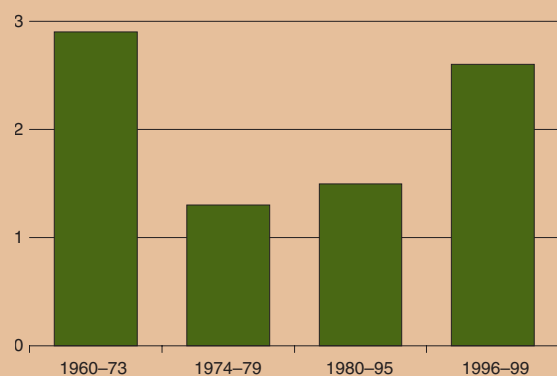
## Box 1.1 U.S. Labor Productivity and Information Technology

The rise in U.S. labor productivity growth from 1.5 percent per year in 1980–95 to nearly 2.6 percent per year in the late 1990s was closely tied to innovations in information technology (IT).<sup>3</sup>

There are three principal sources of productivity growth: capital deepening, represented by increases in the amount of plant and equipment per worker; improvements in technology and in the organization of the production process, otherwise known as multifactor productivity, or MFP; and improvements in the quality of the work force tied to advances in education and increased experience. Oliner and Sichel (2000) calculate the contribution of these three sources of growth to the one-percentage-point acceleration of labor productivity growth in the nonfarm business sector between the first half and the second half of the 1990s: increased use of IT capital (capital deepening) accounts for 43 percent of the upward shift in productivity growth, and improvements in MFP in the computer industries accounts for another 36 percent. In the *World Economic Outlook* (IMF 2000), the International Monetary Fund cites these sources of productivity growth from computers and IT, in addition to investment spillover effects, such as those tied to gaining Internet access as more consumers and businesses establish Internet capabilities.

### Labor productivity growth: nonfarm business sector output per hour

Annual average percentage change



Source: *Economic Report of the President*, U.S. Council of Economic Advisors, February 2000.

### Why now?

Why did it take until the late 1990s for mainframe computers and related IT, which have been widely used over the last quarter century, to have an impact on productivity? The full implementation and widespread adoption of new general purpose technologies usually takes many years, because of both investment and learning costs. Productivity may slow initially because of costs associated with obtaining and implementing the new technology, as well as increased scrap rates, reflecting more rapid obsolescence of old capital. The speed of the recovery in productivity is determined by factors such as the steepness of the learning curve and the time required for the complete replacement of older technologies. Hence, while firms have been investing in computers for many years, associated gains in productivity are only now being realized: managers needed to figure out how to incorporate IT into business processes and staff needed to be trained.

A number of underlying factors contributed to the upswing in productivity growth, including supportive macroeconomic policies and deregulation, the end of the Cold War (allowing resources to be re-deployed from the defense sector to the commercial sector), and trade liberalization (resulting in greater cross-border competition). The combination of advances in IT and deregulation may also have helped by providing tools for the unbundling of risks in capital markets through IT and by creating a more competitive market environment.

### Will the rebound be sustained?

How long the increase in productivity growth will persist depends critically on the penetration of IT productivity gains into the service sector (which represents close to 80 percent of U.S. GDP); evidence on this issue is lacking or unclear.<sup>4</sup> The extensive research on assessing productivity gains in different sectors of the economy has revealed severe measurement problems.<sup>5</sup> However, Triplett (1999) and Jorgenson and Stiroh (2000) stress the importance of industry-level analysis in examining past trends in U.S. productivity growth. Until these information gaps are addressed, evaluating the spread of IT gains

## Box 1.1 (continued)

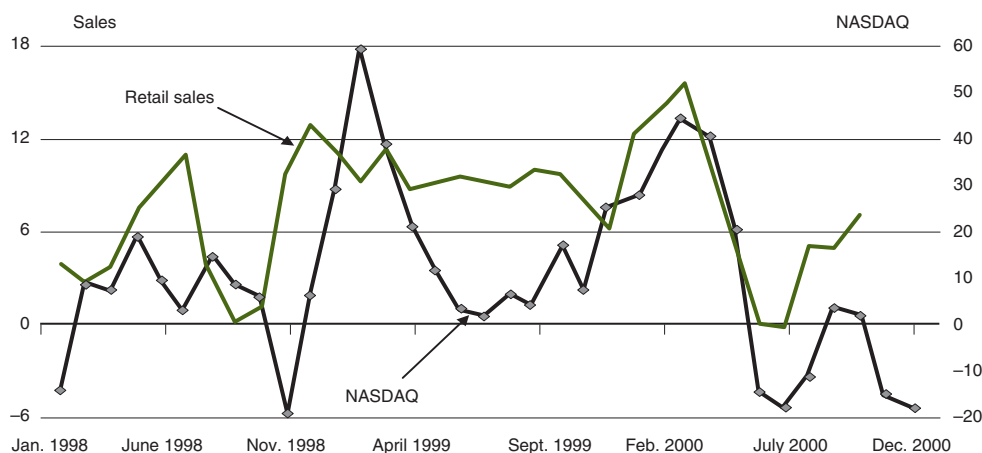
in productivity to other sectors will remain an open question. To this end, Bosworth and Triplett (2000) make a plea for improving U.S. statistical agencies' methods, which have not kept up with changes in the underlying structure of the U.S. economy.

While the transmission of IT productivity gains to the service sector has not materialized fully in the data, it is clear that the demand for IT goods has remained strong, making it reasonable to expect that gains in IT productivity will continue to contribute

positively to overall productivity growth in the United States for some time. Recent evidence suggests productivity appears to be increasing outside of IT sectors: nonmanufacturing productivity has increased noticeably since mid-1999, and productivity in retail activity has been on the upswing since mid-1997 (J. P. Morgan 2000). If these indicators reflect the onset of IT penetration into the production processes of other sectors, then strong productivity growth could continue for some time.

**Figure 1.3 U.S. retail sales and the NASDAQ index**

*Sales: percentage change over three months ago, seasonally adjusted annualized rate; NASDAQ: percentage change over three months ago*

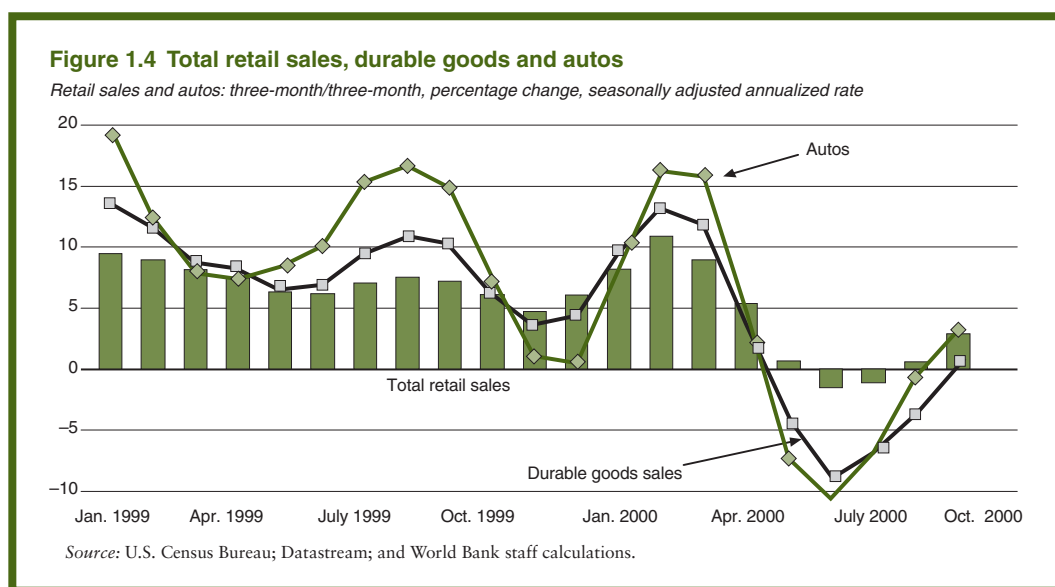


Source: U.S. Department of Commerce and Datastream.

large measure because of strong productivity growth (4.7 percent through the third quarter from a year ago)—suppressing any increase in unit labor costs—and the appreciation of the dollar on the heels of massive capital inflows.<sup>2</sup>

The Federal Reserve's increase in the Federal Funds rate (by 175 basis points in six steps from June 1999 to May 2000) reduced the momentum of consumer demand growth over the course of the first half of the year, with

interest-sensitive sectors such as automobiles and housing being particularly affected (figure 1.4). The slowing of consumption growth was short-lived, however, and third-quarter data revealed a rebound in spending to 4.5 percent growth. Nonetheless GDP advanced at a 2.7 percent pace in the third quarter representing a dramatic slowing to about one-half the rate of the previous year. A sharp decline in business fixed investment was a major factor in the



slowdown, as an unwinding of the high-tech spending boom appears to have begun.

Still, prospects remain favorable for a soft landing and we expect that GDP growth will average 5.1 percent in 2000<sup>6</sup> and about 3 percent on average in 2001–02. The consensus view of financial analysts is that the Federal Reserve is likely to raise interest rates further in 2001 against the background of still rapid domestic demand growth, high oil prices, and continued wage pressures. With a slackening in the pace of economic activity over the course of 2001, policy as well as long-term interest rates should ease moderately in 2002. The underlying risk of a harder landing remains, however, since domestic savings are not expected to recover and the current account deficit is likely to register \$450 billion to \$475 billion in 2000–02 (4.5 percent of GDP). The possibility of tax cuts following the November elections suggests a reduction of the public sector surplus, which would tend to increase the current account deficit yet further. Current financial tensions in the high-yield sectors may be a first sign that financing of large U.S. private debt is becoming increasingly difficult.

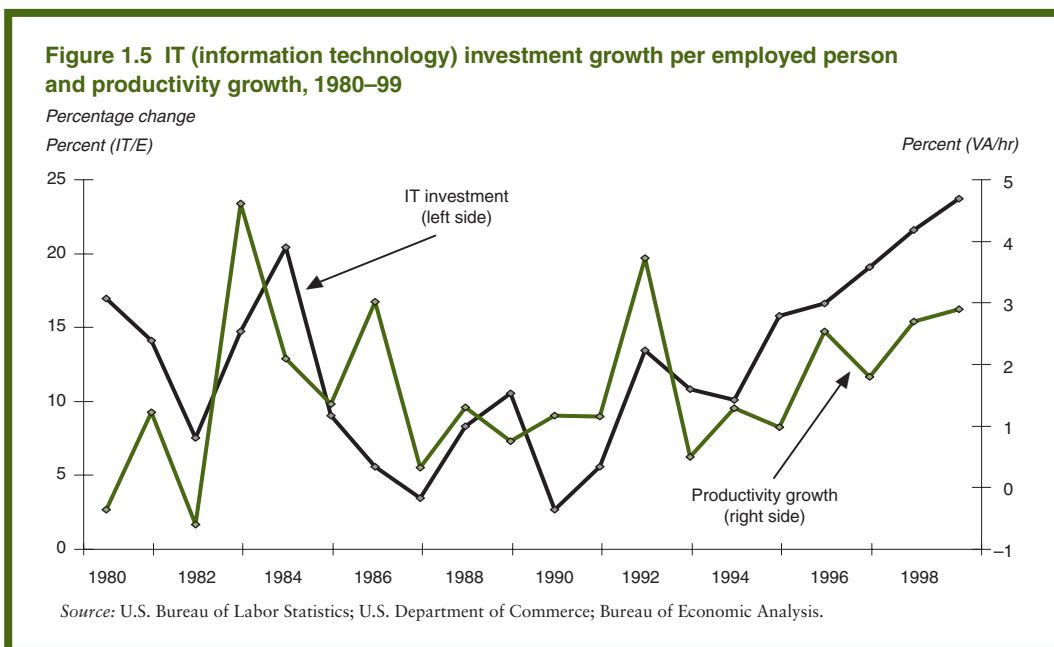
Strong productivity growth is likely to continue over the medium term (box 1.1), as the

rapid growth in IT investment (which has risen over the 1990s at four times the rate of other private capital-spending components) despite cyclical up and downturns is likely to continue at high rates on a secular basis (figure 1.5). With demographic factors likely to slow growth of the labor force to rates below 1 percent per year over the coming decade,<sup>7</sup> long-term potential growth could be as high as 3 or 3.5 percent, without risk of significant inflationary pressure. But achieving this *potential* growth will present policy challenges, as correction of the persistent external deficit will require extended periods of low import demand, a fall in the value of the dollar, or both.

***Japan emerges from recession, but its financial underpinnings are fragile***

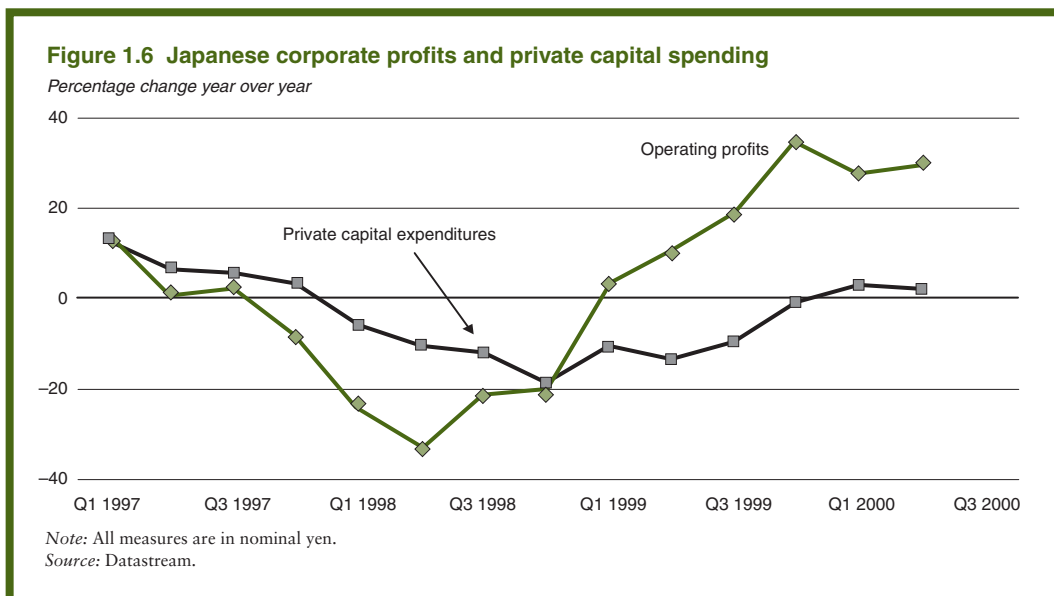
**Japan.** GDP rose by 10.3 percent (seasonally adjusted annualized rate, or saar) in the first quarter of 2000 and 4.2 percent in the second, as public investment increased and a sharp recovery in profits supported private capital spending (figure 1.6). There are now signs that household demand is rising (after a decade of stagnation or decline), grounded in improved labor market conditions. This could give consumer confidence the boost necessary for the

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recovery to maintain momentum. The Bank of Japan has abandoned its “zero” policy interest stance, suggesting that the pickup in activity is sufficiently grounded to withstand the 25–basis point rise. With evidence that industrial corporate recovery is more advanced than anti-

ipated, that public works–related investment is now filtering through the economy, that a nascent upturn in consumer demand could consolidate with rising incomes, and that prospects for Japanese exports remain favorable, we have upgraded projections for GDP growth



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in 2000 to 2 percent, and to a range of 2–2.2 percent over 2001–02.

Recent efforts in the corporate and financial restructuring required for long-term recovery from a decade of slow growth show progress. Announcements of corporate restructuring plans (mostly by larger firms) surged during 1999 and 2000, and many of these plans contained commitments to refocus on core activities, improve long-term profitability, strengthen financial control, and forge links with foreign partners. The government is drafting more workable insolvency laws to help facilitate labor mobility and the scrapping of excess capacity, is providing loans and credit insurance to startups and venture firms, and is easing the process for mergers and acquisitions and employee buyouts. Successful restructuring over the next decade could generate significant gains in productivity, which together with the expected decline in the labor force would imply output growth modestly above 2 percent per year.

Nevertheless, critical challenges remain. Uneven corporate restructuring continues to pose a threat to the near-term recovery. The number of business failures soared to a record in the first seven months of 2000, and debt associated with the failed firms has skyrocketed. Events triggered by the still fragile state of several financial institutions and nonmanufacturing firms could impair consumer and business confidence, as evidenced by the bankruptcy of the Sogo department stores (carrying \$17 billion in debt) after the withdrawal of a proposed government bailout. And Japan's general government gross liabilities will reach 115 percent of GDP in 2000; massive expenditure compression and an overhaul of the tax system will be required to address the debt overhang in the medium term.

*Growth solidifies in the Euro Area, but weak currency is underpinning inflationary pressures*

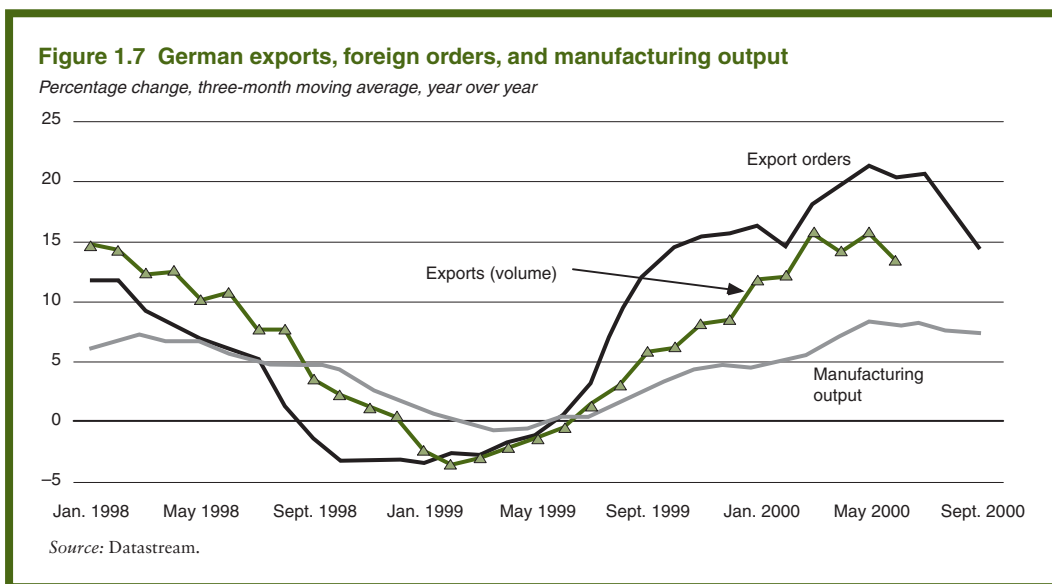
**Euro Area.** During the second half of 1999, improvements in world activity, a competitive exchange rate, and buoyant domestic demand delivered a rebound for the Euro Area from

the crises of 1998, with GDP growth averaging 3.8 percent on an annualized basis. This pace of growth continued unabated in the first quarter of 2000, slowing to an annualized 3.5 percent in the second. A key to the recovery was the momentum underlying export growth, which continued to build during the first half of 2000 toward rates of 10 to 15 percent, with thickening export order books and rising manufacturing production (figure 1.7 highlights the case of Germany).

The European Commission's surveys of consumer and business confidence reached record highs during the first half of 2000, with retail sales rising 3.5 percent in the year to June. Notable after several years of stagnant employment growth has been the creation of over one million jobs in 1999, bringing down Euro Area unemployment to 9 percent from 11 percent in 1998. The economic expansion has also become more broadly based across the region, although Italy remains weak in part because of tightened fiscal policies in the run-up to the European Monetary Union (EMU). Preliminary figures for the third quarter point to a slight slowing and stabilization of activity, partly as a consequence of the oil related terms-of-trade shock and rising interest rates. Higher oil prices and the weak Euro have boosted the harmonized index of consumer prices by 2.8 percent in the year to September, well above the European Central Bank's (ECB) target of 2 percent year-on-year growth. In response, the ECB has tightened monetary policy since November 1999, gradually raising the repurchase rate by 225 basis points to 4.75 percent in October. Further hikes in policy rates appear likely in order to prevent a translation of high current inflation into higher price and wage expectations—or so-called second-round effects.

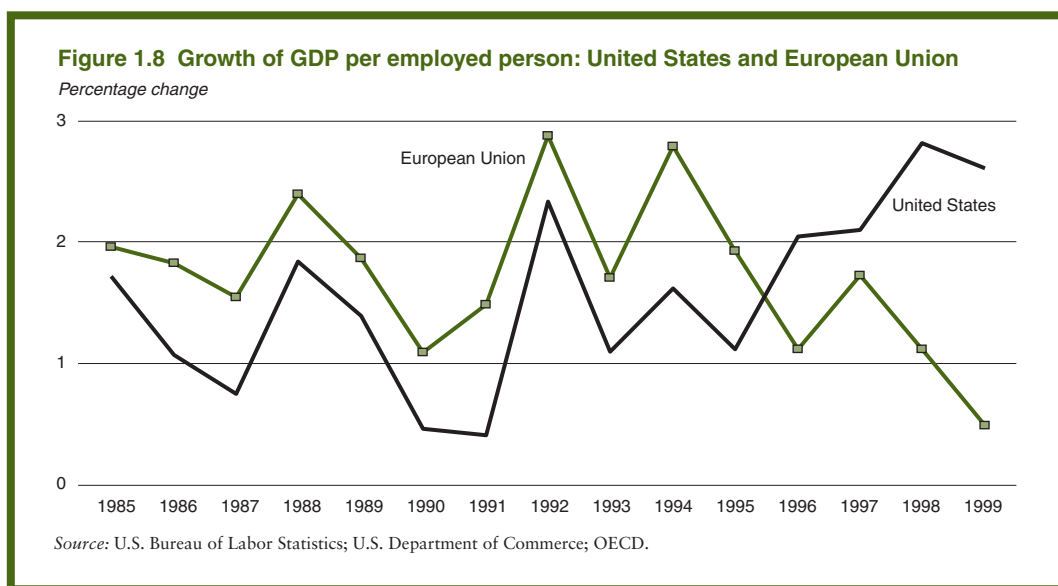
Recovery in 2000 will likely result in Euro Area growth of 3.4 percent, up from 2.4 percent in 1999. Looking forward, growth should be supported by continued firm consumer demand—bolstered by tax reductions in France, Germany, Italy and Spain—with stronger spillovers to fixed investment, and the expected

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unwinding of the terms-of-trade shock as oil prices fall. Yet growth will be restrained by the higher interest rate environment and slowing from exceptionally rapid growth in a number of smaller countries (such as Belgium, the Netherlands, and Spain). These factors suggest a slight moderation in growth toward 3.2 percent in 2001 and further to 2.8 percent in 2002.

Economic performance in the major European countries is expected to improve substantially over the next decade compared with the 1990s, when low productivity growth (1.3 percent during the second half of the decade—figure 1.8), persistent unemployment, and sluggish capital spending limited GDP growth to less than 2 percent per year, compared with



more than 3 percent in the United States. Potential growth rates may be as high as 2.8 or 3.0 percent underpinned among other things, by the introduction of the euro; the growing participation of women in the labor force; and the possibility of “New Economy” contagion. EMU comes on the heels of increased competition in the financial field stemming from the internal market, deregulation, and rapid technological process, thereby accelerating the move towards integrated and more efficient capital markets. The more than doubling of the value of M&A activities and of corporate bond issues in 1999 is some evidence of the early impact of the EMU. The eastward expansion of the EU could enhance the positive growth scenario outlined above. Alternatively, difficulties in absorbing substantial new population blocs into the union could present risks to future growth.<sup>8</sup> Questions regarding intra-EU labor mobility and especially the Common Agricultural Policy (CAP) will become more pressing as expansion moves forward.

## **World trade remains on a long-term high-growth path**

The 1990s witnessed a dramatic acceleration of world trade, both in comparison with the 1980s and in relation to growth in GDP, driven by technological change and the removal of trade barriers (figure 1.9). World trade is likely to continue to grow strongly, although somewhat below the current record pace.

### *Global trade is now at a cyclical high*

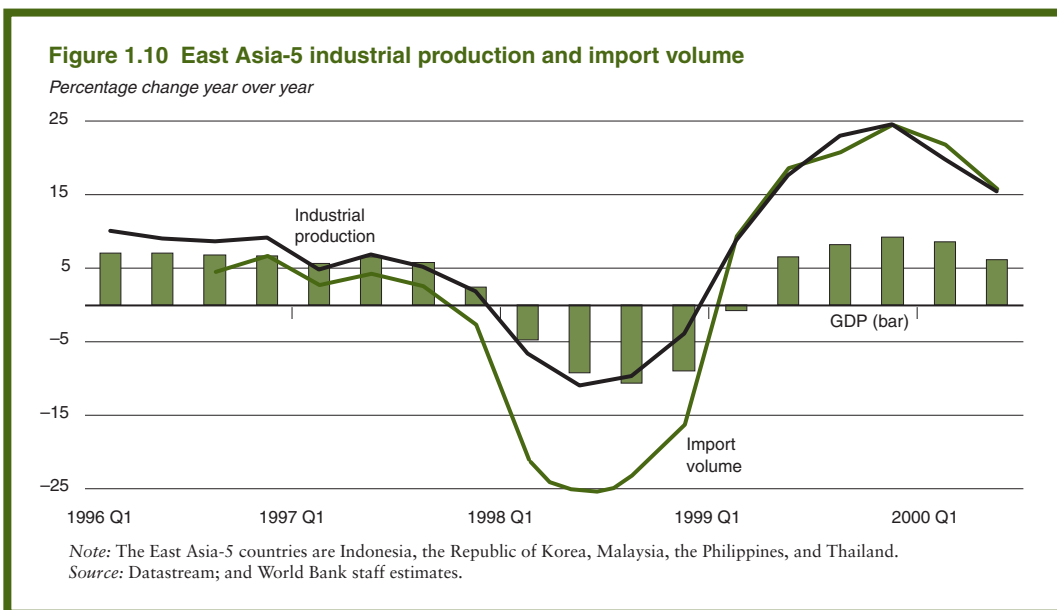
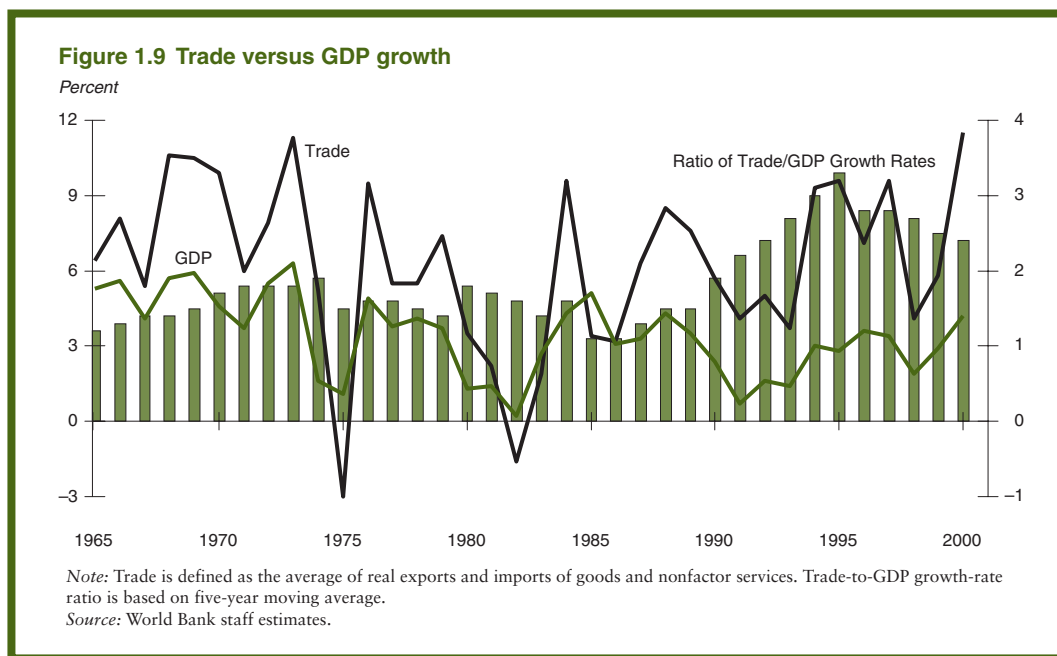
World trade accelerated in the second half of 1999, peaked at 14 percent (year on year) in the first quarter of 2000, and is expected to average a remarkable 12.5 percent for the year as a whole, the highest annual rate of growth since before the first oil crisis. This robust growth was supported by strong demand growth in industrial countries and the recovering economies of East Asia (which contributed 25 percent of the growth in world demand in 1999). After the financial crisis, industrial production in the crisis countries surged to refill inventories and stocks

of capital goods and consumer durable goods (figure 1.10). Demand for foreign durable goods and intermediate inputs increased at the same rate. As industrial production will rise faster than GDP only temporarily, the extraordinarily strong import demand is only transitory. Other regions recovering from the crisis showed similar, although weaker, patterns.

In addition, real exchange rate depreciation fueled developing countries' export volumes. East Asian countries' real exchange rates depreciated by an average of 23 percent in 1999 compared with June 1997 levels, resulting in strong gains in market share—though there were short-lived losses in U.S. dollar terms—(figure 1.11, first panel). Brazil, Colombia, Ecuador, and Peru also undertook large exchange rate adjustments in early 1999 (although the average real exchange rate in Latin America in 1999 was only 7 percent below precrisis levels).

Even China, which initially gained export market share in U.S. dollar terms because of its policy decision to hold the renminbi fixed during the crisis period, benefited handsomely from the cyclical upturn with export volumes growing in excess of 35 percent year on year in the first half of 2000. This can be compared with China's record of no growth in this area between October 1998 and April 1999. In contrast, Latin American countries (excluding Mexico) experienced significant losses in market share in 1999 (figure 1.11, second panel), and the rebound witnessed in the first half of 2000 was weak in comparison to that of East Asia. Export volumes continued to grow strongly in Mexico throughout the crisis period of 1997–99 and averaged about 15 percent in the first half of 2000, despite an appreciating real exchange rate, owing to strong links to U.S. manufacturing developed through the globalization of production and cemented by the North American Free Trade Agreement (NAFTA). Similarly, exports from Central European economies benefited from their increasingly close ties to Western Europe (particularly Germany) as they progress toward full accession to the EU (figure 1.11, third panel).

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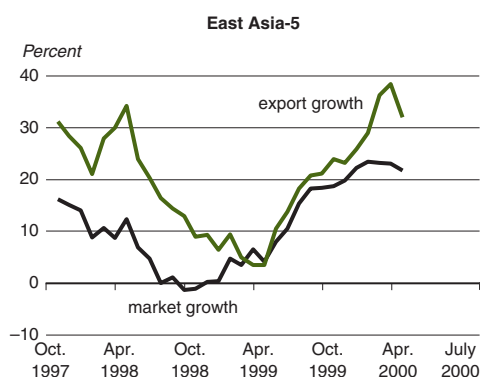
**Structural factors boosted trade during the 1990s**

Developing countries' exports increased by 10 percent per year during the 1990s, triple the growth rate during the 1980s (figure 1.12).

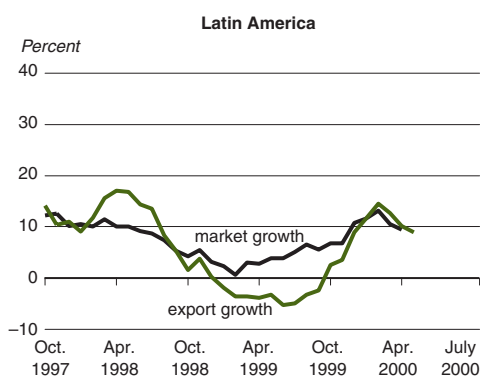
Privatization and more intense competition in domestic markets increased the incentive to find lower-cost intermediate inputs and to search for new export markets. Technological advances reduced communications and trans-

**Figure 1.11 Export volume and market growth, 1997–2000**

Three-month moving average, year over year



Note: The East Asia-5 countries are Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.  
Source: Datastream; and World Bank staff estimates.



Note: The Latin American countries in the graph above are Argentina, Brazil, Chile, and Colombia.  
Source: Datastream; and World Bank staff estimates.

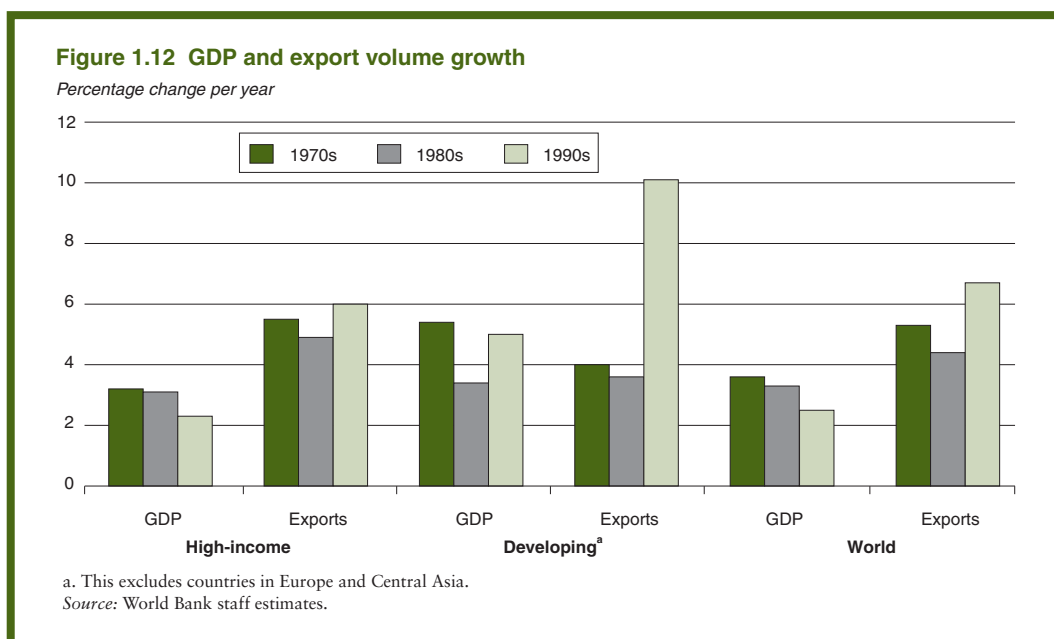


Note: The Central European countries in the graph above are the Czech Republic, Hungary, and Poland.  
Source: Datastream; and World Bank staff estimates.

portation costs, greatly facilitating marketing and outsourcing of production (World Bank 1992, 1997). And regional and multilateral agreements have reduced barriers and greatly contributed to the acceleration in trade.

*Multilateral agreements.* Negotiations under the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) have provided an enormous impetus to trade. Multilateral agreements were primarily responsible for the reduction in average tariff rates in industrial countries and the removal of a wide range of nontariff barriers through the mid-1990s, when the Tokyo Round was fully implemented. Further, the GATT negotiations have exerted important influences on other negotiations and trade policy in general. Precedents established under the GATT have guided regional arrangements.<sup>9</sup> The GATT has provided an important venue for many countries to participate in trade negotiations, sometimes for the first time; has established a wide variety of standards (such as tariffication, import valuation, standards for trade in food and animals [SPS agreement], protection of intellectual property [TRIPs agreement], and so forth); has contributed immeasurably to maintaining stable rules of the game in international trade relations, by facilitating dispute settlement and constraining unfair trade practices;<sup>10</sup> and has heightened awareness of the importance of international trade and encouraged significant improvements in countries' capacity for trade administration and negotiation.<sup>11</sup>

*Regional agreements.* Regional agreements played an increasingly important role in the global trading system during the 1990s (box 1.2). They have often provided opportunities for more comprehensive dismantling of trade barriers and greater harmonization of rules governing trade than can be accomplished under multilateral negotiations. This is particularly true of the EU and NAFTA, both of which developed important precedents for multilateral negotiations and other regional arrangements. There are many reasons for entering regional trade agreements—many of a political economy nature. However, there are



significant concerns over their economic benefits. Regional trade agreements shift import supply from external countries to countries within the free trade area. This may lead to reduced efficiency for the countries within the free trade area if external suppliers are lower-cost suppliers. Also, those outside the agreement suffer from lost market share or lower supply prices.

A myriad of other regional integration agreements have evolved (figure 1.13 and annex table A1).<sup>13</sup> Some of these agreements are designed to address similar leverage and harmonization issues that faced the EU and NAFTA. Some countries have undertaken more ambitious efforts at regionalism, for example, the members of the Association of Southeast Asian Nations and the Asia-Pacific Economic Cooperation.

It is extremely difficult to measure the relative importance of regional and multilateral agreements to the expansion of trade. Multilateral agreements that lead to increased growth may spur intraregional exports because of lower transport costs (than outside the region) and other agglomeration effects

(for example, greater knowledge of closer markets than of extraregional ones). Conversely, regional arrangements can stimulate global trade through improving the efficiency and hence competitiveness of regional producers and expanding demand for inputs from nonregional sources. Nevertheless, the existing data do indicate that some regional arrangements have been associated with expanded trade. The growth of intraregional trade was significantly greater than the growth of exports outside the region in NAFTA and the EU during the 1980s, and in NAFTA and Mercosur (the Latin America Southern Cone trade bloc) during the first half of the 1990s (table 1.2). The EU during 1990–95 is an exception, owing to the relatively slow growth in Europe following German reunification.<sup>14</sup>

Many of the other regional arrangements lack the economic diversity required to meet the bulk of their trade needs. Only three of the non-NAFTA and EU agreements have more than 20 percent of their average trade within their respective regions (figure 1.14). Nonetheless, regional integration arrangements may cover a growing share of trade in the future.

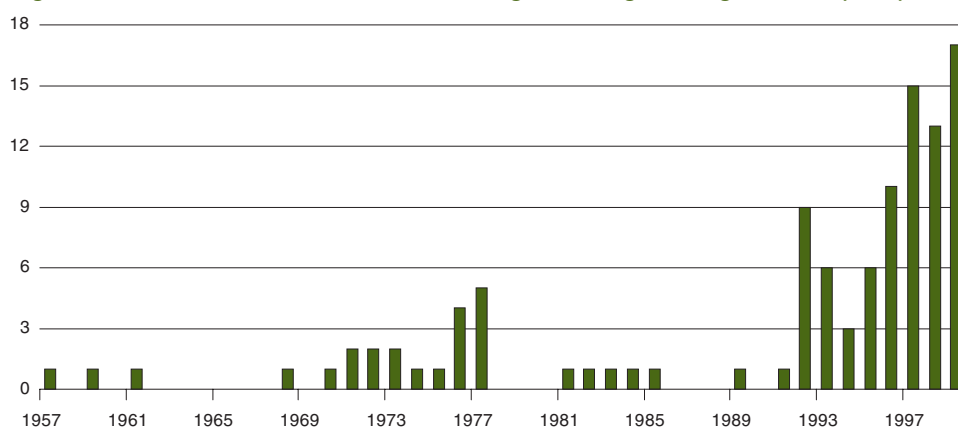
## Box 1.2 North-South regional arrangements

One distinguishing feature of NAFTA, its North-South orientation, is of special relevance to developing countries, and this fact alone makes it likely to influence most regional integration agreements (RIAs) in the future. Motives for North-South agreements are many. Included among these are the usual regional incentives such as shared history, trade, and transport economies. Agreements between industrial and developing countries also imply more extensive shifts in specialization (and thereby greater gains from trade) than regional agreements among developing countries alone. North-South agreements have also encouraged developing countries to lock in domestic economic and other reforms,<sup>12</sup> enhance prospects for market-driven development strategies, and increase the likelihood of lower external tariffs. From the developing-country partner perspective, these include enlargement of export markets, accelerated foreign capital inflows, technology transfer, and possibly enhanced mobility of other factors.

These strategic properties should make North-South agreements more attractive to developing countries than South-South arrangements, since the latter have more limited potential for exploiting comparative advantage or capturing growth externalities and can lead to trade diversion and greater economic divergence. Moreover, North-South RIAs are more likely to foster economic convergence that, if it coincides with accelerated growth, can be beneficial to all partners. Surely this fact explains the willingness of both sides to extend existing successful regional agreements outside their immediate boundaries. The EU is currently expanding trade partnership in two “southern” directions—Eastern Europe and the Maghreb. The NAFTA is also looking as far as the Southern Cone to expand its economic ties.

Source: World Bank 2000d.

Figure 1.13 Number of WTO notifications of regional integration agreements (RIAs)



Source: World Trade Organization.

The vast increase in the number of countries participating in the WTO has greatly complicated negotiations, a fact that may lead countries to focus more on regional arrangements

with smaller memberships, where reciprocal concessions can be more transparent and immediate (thus facilitating the negotiating process). Smaller memberships may also make

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**Table 1.2 Intra- and extraregional trade**  
(annual percentage change in exports)

	1980-90		1990-95	
	Within region	Outside region	Within region	Outside region
NAFTA	15.6	9.8	9.9	5.3
European Union	16.1	10.9	3.2	6.6
Mercosur	4.3	9.3	27.5	4.0

Source: World Bank staff data.

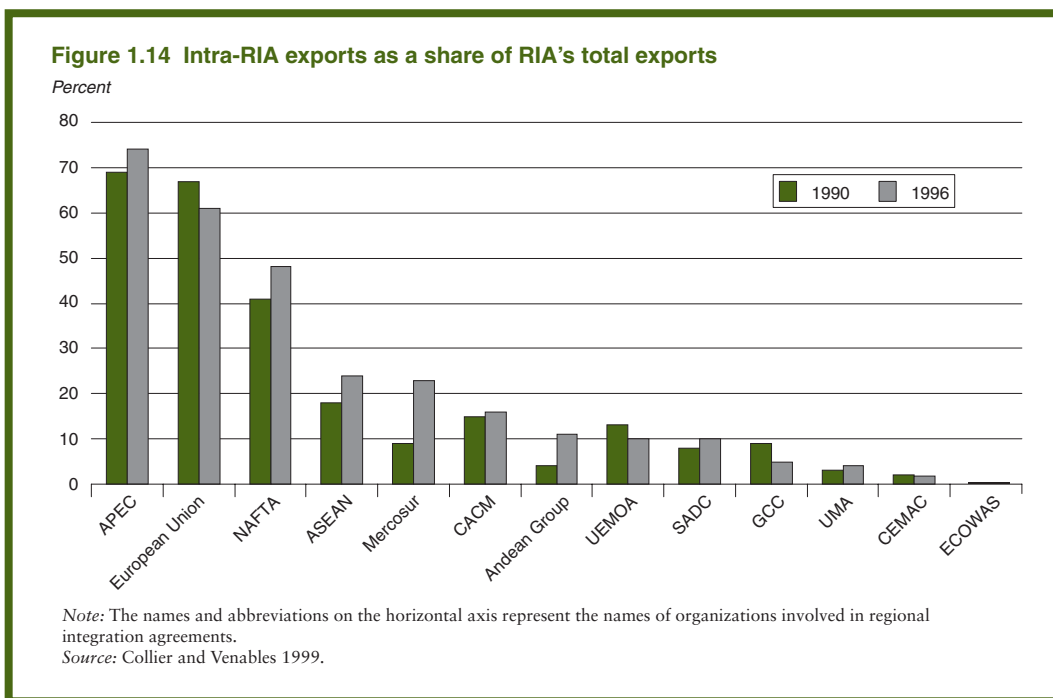
it easier to negotiate the increasingly important issues inherent in product standards (see chapter 3).

### Prospects for trade growth

Strong growth momentum in industrial country import demand in the first half of the year will bolster developing-country export volume growth to 12-13 percent in 2000. However, world trade growth is likely to slow over the course of the year, in line with the expected slowing of world industrial production. In-

dustrial production in key developing regions (such as East Asia and Latin America) had already slowed by the second quarter. While some upturn is likely for these countries in the second half, overall momentum is unlikely to return to the rates experienced in the latter half of 1999 and the first quarter of 2000.

Growth in world trade volumes is projected to slow to 8.0 percent in 2001 and 6.8 percent in 2002, for a number of reasons. First, the cyclical pattern of world GDP growth is expected to move toward more sustainable long-run rates, thereby reducing import demand. For example, U.S. import growth, which reached 13 percent (year on year) in the first half of 2000, is likely to slow toward 7 or 8 percent in 2001-02, helping to stabilize the widening trend in the current account deficit. This is unlikely to be offset completely by increases in import demand in other major trading countries. Second, gross private capital flows to developing countries are expected to rise by only 15 to 20 percent over the next two years, well below the rate of increase in



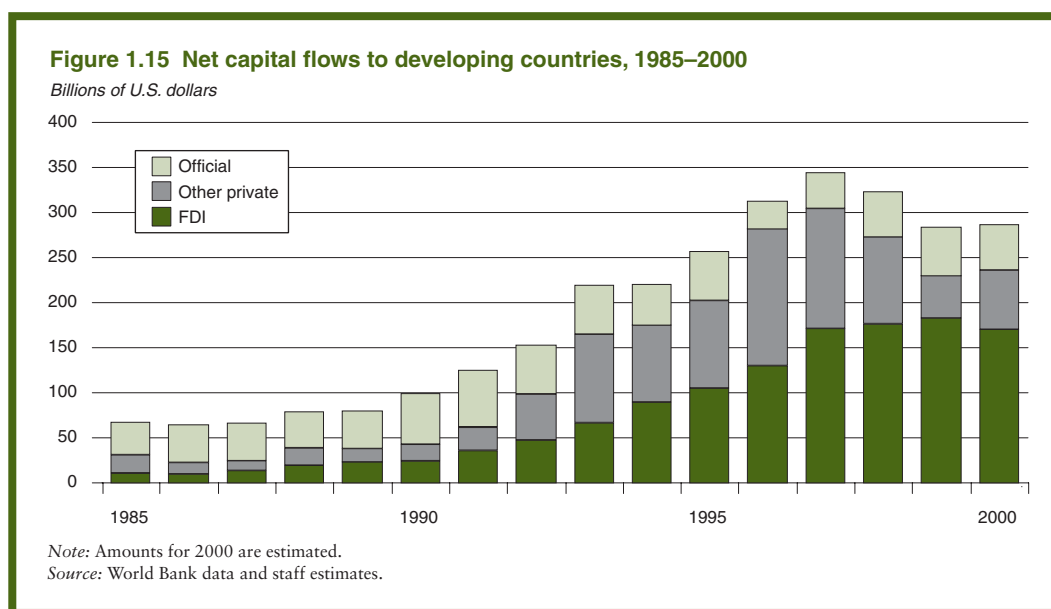
1996–97, when large capital flows permitted some developing regions (such as Latin America) to boost imports. Third, the terms of trade for oil-importing countries are likely to remain soft in the near term, as oil prices stay relatively high and non-oil commodity prices rebound weakly. This, in combination with fairly sluggish private capital flows, would tend to limit the ability of oil-importing countries to sustain rapid import growth for an extended period. However, none of the above factors are expected to cause a massive deterioration in world trade growth in the near term.

In the longer term (2003–10), world trade is projected to grow by 6.8 percent a year. The long-term forecast for trade growth is 2.1 times the projected rate of world GDP growth, lower than what was observed in the 1990s but still much higher than in the 1980s. The very high ratio of the 1990s was in part due to the one-time increases in integration represented by the EU single-market initiative and NAFTA as well as large-scale trade liberalization in a number of developing countries. While participating countries will continue to benefit from increased integration, it is unlikely that further reductions in trade barriers will be of the same magnitude.

Other forces may boost world trade growth in comparison with the 1990s. For example, there may well be improvements in information technology (see the section on industrial countries and chapter 4), and another round of trade negotiations may be successfully concluded (despite the derailing of the launch of a new round in Seattle in December 1999). While any quantitative comparison of these influences is extremely speculative, on balance we anticipate some decline in the ratio of world trade growth to output growth.

## Private capital flows remain volatile

The surge in globalization during the 1990s was even more spectacular in capital flows than in trade flows. Net long-term capital flows to the developing countries surged from \$80 billion in 1989 to \$344 billion just before the financial crisis, before falling to \$280 billion in 1999 (figure 1.15). FDI flows grew steadily to \$180 billion in 1999, almost eight times their level at the beginning of the decade. Other private flows have been extremely volatile—increasing tenfold between 1989 and 1996, but declining



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70 percent during the last three years of the decade. Total official flows fluctuated around \$50 billion, with significant dips in 1996 and 1997. Preliminary data for 2000 covering gross flows suggest that total inflows stabilized, with the share of FDI declining somewhat from its high level of 1999.

## *Stabilization of capital flows in the short run*

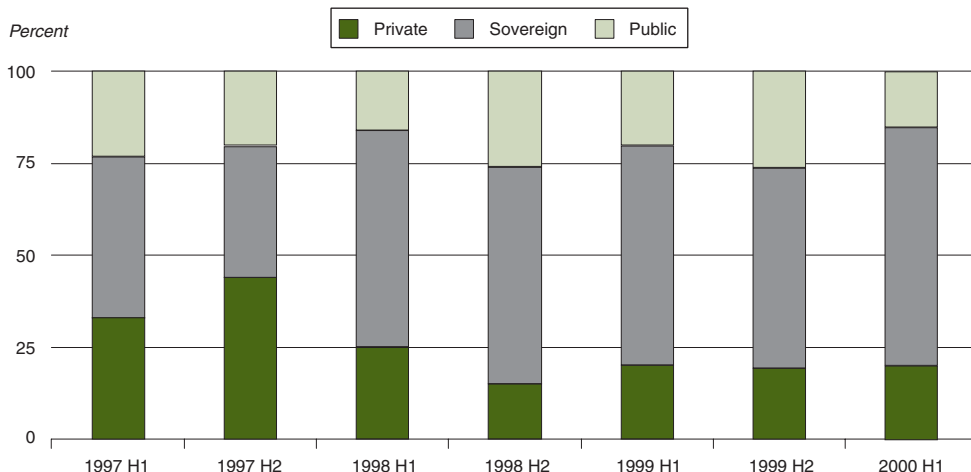
The stabilization of international capital flows into developing countries was initially driven by a reduced supply of funds by international investors, but now it increasingly reflects improved domestic credit conditions and a sharp rise in capital demand in the industrial world. Most countries affected by the financial crisis brought inflation rapidly under control while achieving currency stability after large devaluations and current account adjustments, and this opened the way for more accommodating monetary policies. Improved domestic credit conditions, combined with large current account surpluses, reduced the need for international financing. At the same time, the current account deficits in the high-income countries

increased from \$9 billion in 1998 to \$175 billion in 1999, and they are expected to reach \$250 billion in 2000. With an increased domestic savings shortfall from \$218 billion to \$435 billion during the last two years, the United States (which saw an investment boom) was the main source of the deterioration of the current account in the industrial world.

Continued uncertainty and risk aversion following the financial crisis constrained market-based flows (bonds, bank loans, and equity) to several of the emerging market economies in 2000. The average risk premium on developing-country secondary market debt remained high. New financing primarily targeted less risky borrowers: 60 percent of total developing-country bond issuance came from sovereign borrowers (compared with 55 percent in 1999), and the share of private borrowers remained low (figure 1.16). Moreover, a substantial proportion of bank lending (55 percent) went to finance the rollover of upcoming liabilities or took the form of less risky lending, such as trade finance or securitized lending.

The volatility of capital flows in the second quarter underlined the continued vulnerabil-

**Figure 1.16 Sectoral breakout of bond financing by developing countries, January 1997–June 2000**



Source: World Bank data and staff estimates.

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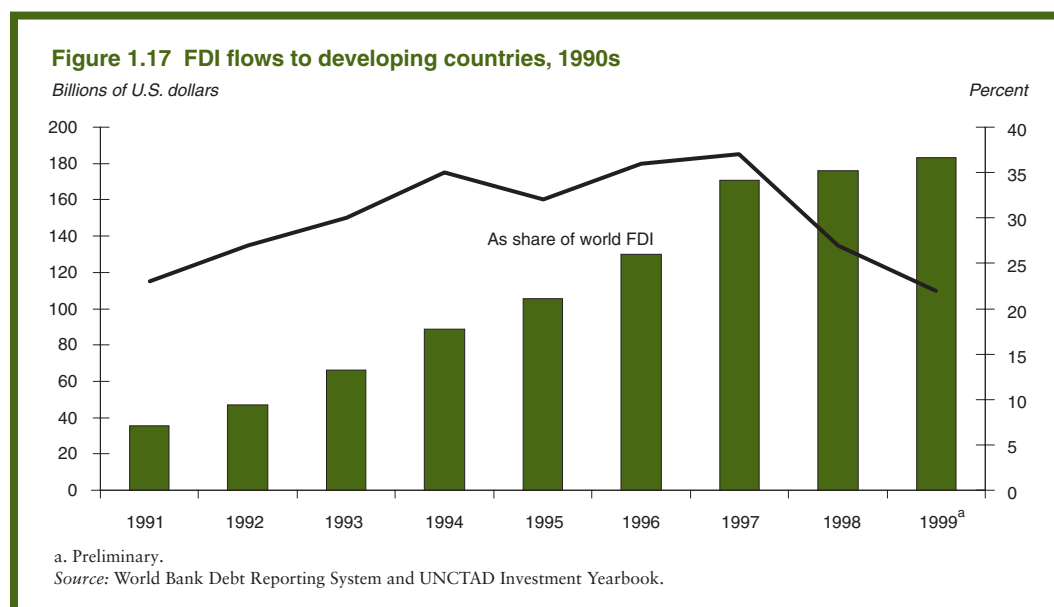
ity of developing countries to shifts in investor sentiment. A sharp correction in the U.S. NASDAQ market was associated with a jump in volatility in developing-country stock markets,<sup>15</sup> and the risk premium on developing-country external debt rose to 850 basis points (compared with 760 basis points at the start of the year). In April, the volume of capital flows to developing countries dropped by 75 percent over March, and it declined marginally further in May before recovering in June to almost the March level.

For the first time in over a decade, preliminary data suggest a contraction in FDI flows to developing countries in 2000 from the \$180 billion recorded in 1999<sup>16</sup> (figure 1.17). The downturn in FDI was brought about by reduced commitments for new projects in major recipient countries, combined with a slowdown in M&A activity, and completion of large-scale privatization projects. China, the largest recipient of FDI, experienced a substantial reduction in the value of new commitments during the past years, from \$111 billion in 1993 to \$52 billion in 1998 and \$41 billion in 1999.<sup>17</sup>

## *In the long term, capital flows should regain momentum*

FDI flows to developing countries are likely to rise over the long term, as rapid international integration continues (witness the recent wave of cross-border mergers and acquisitions among corporations in the industrial countries),<sup>18</sup> and developing countries' growth rates continue to exceed growth rates in the industrial world. Renewed cross-border M&A activity in Korea and in other East Asian countries could raise FDI inflows to the region. And political commitment to removing obstacles to privatization may accelerate postponed projects in a number of Central and Eastern European economies. However, the growth of FDI is unlikely to be spectacular as it was in the 1990s.

Other private capital flows are expected to regain some momentum from their current depressed levels. A narrowing of current account imbalances may increase demand in some developing countries, and further progress in financial reforms should go some way toward restoring the confidence of international investors. However, capital market flows will re-



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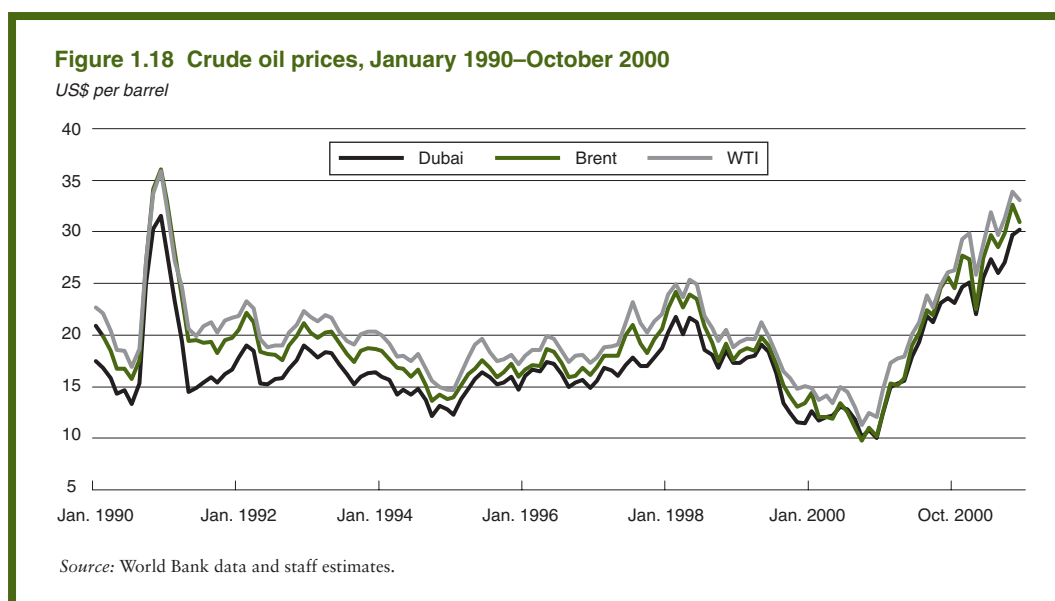
main volatile, in turn contributing to the uncertainty in the real economy. For that reason, FDI flows are likely to continue as the primary source of international funding for developing countries, in the process helping to reduce vulnerability to financial shocks.

## Commodity prices exhibit divergent recoveries

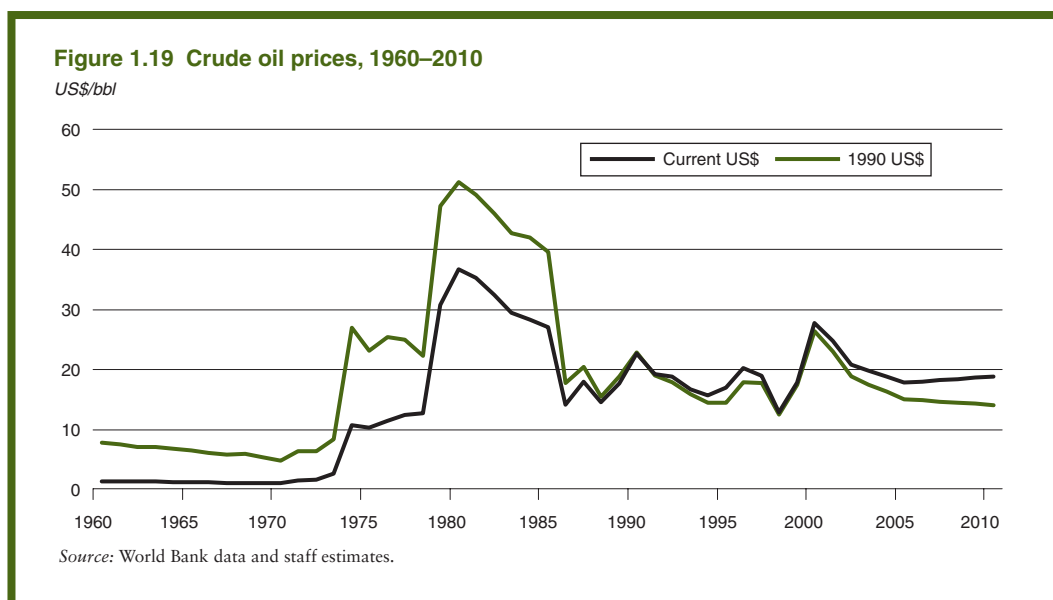
**O**il prices. The present oil price shock is expected to be temporary, since it was generated by the confluence of a number of unexpected short-term factors. The spike in oil prices has its roots in the reaction to the 1998 price decline in the wake of the financial crisis—a decline that in real terms placed the oil price at one-quarter of its peak level of 1980. OPEC members, along with some non-members, agreed on production cuts in 1999 to boost prices, while low prices also led to a slowdown in the growth of non-OPEC production and in investment in the oil sector. The drop in production coincided with the unexpectedly strong rebound in world economic activity in 1999, and hence in oil demand. Oil inventories fell dramatically, and prices sky-

rocketed (figure 1.18). OPEC has responded to the near-term shortage in the market by raising its production ceiling back to the levels of early 1998. A combination of supply increases and some decline in demand (from higher prices) should reduce oil prices from an average of \$28 per barrel in 2000 to \$25 per barrel in 2001 and \$21 per barrel in 2002.

Plausible worst-case scenarios (for example, an unusually cold winter or unanticipated supply disruptions) could see prices averaging \$30 a barrel in 2000 and 2001, with temporary spikes running to \$50 or more. Depending on policy and private sector reactions, such higher prices could pose a substantial threat to global expansion, particularly if the shock contributes to steep declines in the several highly valued industrial country equity markets (the implications are explored in the low-case scenario—see below). However, it is difficult to see significantly higher prices being sustained for more than a year or two, given that non-OPEC production would increase in response. Prices are expected to average about \$18 to \$19 per barrel for the rest of the decade, as technological improvements (for instance, better methods of locating and recov-



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ering crude oil) boost energy production and conservation efforts continue.

The impact of the current oil price rise on industrial countries has been less than the impact of price rises during the oil price shocks of 1973–74 and 1979–80, because the current increase is smaller and output is much less dependent on oil than before. Oil prices in 2000 should average about half the level of the 1979–80 oil shock in real terms (figure 1.19).<sup>19</sup> Nevertheless, the oil price rise has increased inflationary pressures and trade deficits in some of the industrial countries, as well as exacerbating tensions over the level of gasoline taxes.

Oil-importing developing countries have been more severely affected than industrial countries, because they consume more energy per unit of output and have less access to the external financing required to sustain expenditure levels until oil prices decline. Moreover, prices for their primary commodity exports (especially tropical beverages and other agricultural goods) have continued to drop over the course of 1999 and 2000, so their terms of trade have fallen precipitously.

To illustrate the effects of higher crude oil (and natural gas) prices on developing coun-

tries, table 1.3 presents the impact of a \$10 per barrel increase in price (the average increase anticipated in the baseline for 2000) on current account positions for a sample of 92 countries. While the current account balance of oil-exporting developing countries is expected to improve by about \$135 billion (at unchanged oil trade volumes) as a result of the oil price increase, that of oil-importing developing countries is expected to deteriorate by about \$40 billion, or a little over 1 percent of GDP.

Because the oil shock is expected to be temporary, there is a good economic case for oil-importing countries to meet higher bills for oil and gas imports through temporary balance of payments deficits and external financing rather than through adjustment. However, there is a good deal of uncertainty about how high prices will go and for how long, and even a temporary shock could make international lenders jittery about the sustainability of countries' external debt. This uncertainty increases the risk of a sudden withdrawal of external finance. It is thus likely that risk-averse policymakers in oil-importing countries will undertake some degree of prudent adjustment.

The oil-importing emerging market economies should be able to smooth the impact of

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**Table 1.3 Current account effects for a sample of developing countries from a \$10 increase in oil prices**

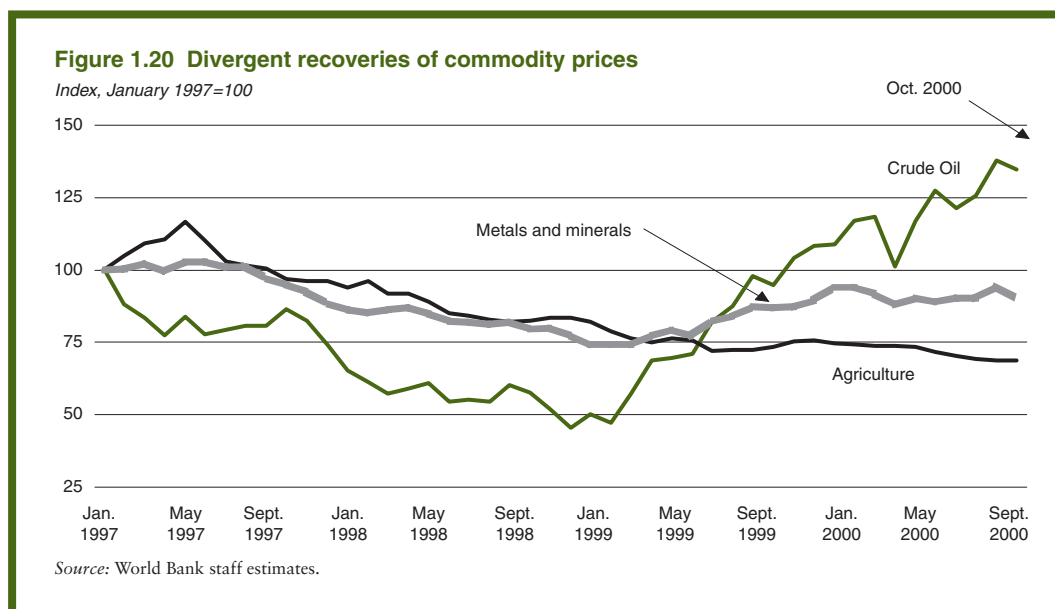
	Oil importers			Oil exporters			All developing countries		
	Number in sample	\$US bln.	as % GDP	Number in sample	\$US bln.	as % GDP	Number in sample	\$US bln.	as % GDP
East Asia and Pacific	7	-16	-1.0	3	7	2.0	10	-9	-0.7
South Asia	5	-5	-0.9	0	0	0.0	5	-5	-0.9
Latin America	15	-4	-0.7	7	22	2.0	22	18	0.8
Sub-Saharan Africa	13	-2	-0.7	5	13	19.5	18	11	3.2
Europe and Central Asia	18	-14	-1.7	3	27	10.3	21	13	1.5
Middle East and North Africa	6	-2	-1.1	10	66	11.4	16	64	8.6
<b>Total developing countries</b>	<b>64</b>	<b>-43</b>	<b>-1.1</b>	<b>28</b>	<b>135</b>	<b>5.7</b>	<b>92</b>	<b>92</b>	<b>1.5</b>
<i>Memo item: HIPC</i>	13	-2	-1.4	6	5	19.0	19	3	1.7

Note: The table shows the direct current account impact (keeping volumes constant) of a \$10/bbl increase in crude oil and refined products and a (similar) 54% increase in the gas price.

the shock with private finance, though some with already large current account deficits will have to proceed with caution. Oil-importing developing countries without access to private capital markets will face an additional official financing need of about \$18 billion (without adjustment). Since countries will be undertaking some degree of adjustment (leading to a lower financing need), and the need for official aid flows to oil exporters may be much less for

a time, the net additional call on international donors does not appear insurmountable.

*Non-oil commodity prices.* Non-oil commodity prices began to decline in early 1997 and then plummeted with the East Asian crisis (figure 1.20). While the global economic recovery has led to some recovery of metals and minerals prices, agricultural prices continue to languish near their cyclical troughs. This divergent recovery is not surprising, since met-



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als, which are used as inputs to industrial production, have higher short-run income elasticities than food and beverages.

After the price declines in 1998, metals and minerals producers cut production at high-cost mines and smelters, leading to some slowdown in production growth. For example, copper production slowed to 3 percent growth in 1999, from 4 percent in 1998. At the same time, the strong global economic recovery boosted demand for metals. Consumption of copper rose 4 percent in 1999 and will rise an expected 6 percent in 2000, while aluminum consumption rose 6 percent in 1999 and is up 5 percent in 2000. Slower production growth and accelerating demand have reduced stocks, and metals and minerals prices are estimated to have risen above 14 percent in 2000, to a level about 20 percent above the cyclical trough.

In contrast, agricultural prices remained stagnant for most of this year. Despite this, the United Nations' Food and Agricultural Organization's index of global agricultural production rose by 1.6 percent in 1999 (slightly below the 30-year trend growth rate of 2.2 percent), which contributed to further stock buildups. Consequently, world stocks of most agricultural commodities remain high—and in some cases stocks have continued to increase. Sugar stocks, for example, rose for the fifth consecutive year in 1999, while cocoa stocks reached the same levels as in 1990–91, when the International Cocoa Organization was operating a buffer stock mechanism. An exception to this trend is cotton, for which production is expected to decline by 2 percent, contributing to a 15 percent reduction in stocks. Moreover, recovery in demand has been weaker than in metals. Grain consumption is expected to be roughly unchanged in 2000; but consumption of raw materials is recovering, led by cotton, which is expected to increase 2 percent next year.

Recent trends in commodity prices have obviously favored food importers (particularly the oil-exporting countries, which simultaneously have benefited from higher oil revenues), while net agricultural exporters, such as many

countries in Latin America and Sub-Saharan Africa, have seen substantial deterioration in their commodity terms of trade. Côte d'Ivoire, Ghana, Kenya, and Uganda all receive 40 to 60 percent of export earnings from agriculture (mainly coffee and cocoa), and fuel imports constitute 20 to 30 percent of import costs. Most Asian countries have been less affected, since they are less dependent on agricultural exports and fuels are a smaller share of total imports.

Non-oil commodity prices are expected to increase in the near term, gradually aligning with the continued expansion of the global economy (table 1.4). Metals and minerals prices, which rose about 14 percent in 2000, are expected to increase about 2 percent per year in nominal terms over the next several years, but more rapid increases are possible if global economic growth is higher than anticipated.

The recovery in agricultural prices is expected to remain slow, as supplies continue to increase at nearly the same pace as consumption. But experience shows that current low prices in agriculture could give way to a surge in the near to medium term. While it is difficult to predict when such an event might occur, historical evidence indicates that it could begin about two to three years after the cyclical low.

Over the longer term, non-oil commodity prices are likely to decline in real terms, continuing the trend over the past 100 years (real non-oil commodity prices fell by nearly two-thirds during the twentieth century, and by half over the last two decades—[figure 1.21]). There appears to be no letup in the improvements in technology that boost commodity supplies at lower cost. Crop yields continue to increase along historical trends, and new plant-breeding techniques offer the prospect of further increases. Improved mining and refining techniques reduce the cost of recovering ore and producing metals. On the demand side, population growth is projected to slow from 1.4 percent during the 1990s to 1.1 percent during the first decade of the 21st century and 0.9 percent during the second decade. In Asia, where the demand for commodities has

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**Table 1.4 Annual percentage change in nominal oil and non-oil commodity prices, 1981–2010**

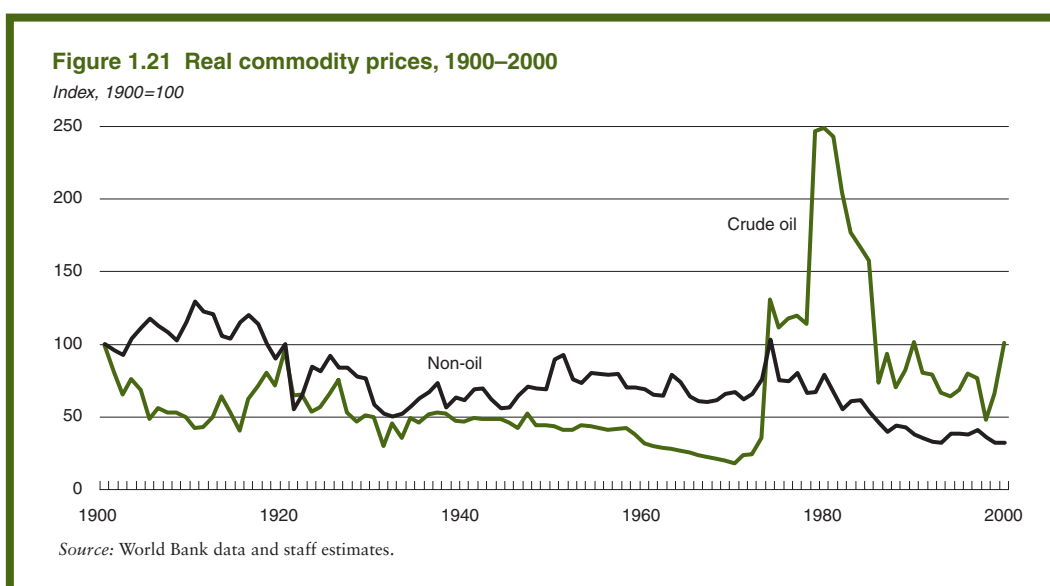
Commodity	1981–90	1991–97	1998	1999	Forecasts		
					2000	2001	2002–10
Oil	-4.7	-2.5	-31.8	38.3	55.0	-10.7	-3.0
Non-oil	-2.2	2.3	-15.7	-11.2	-0.8	3.4	2.8
Agriculture	-3.2	3.7	-16.3	-13.9	-5.2	3.9	3.3
Food	-3.3	2.2	-9.8	-16.5	-3.9	5.1	2.4
Grains	-2.9	1.6	-9.7	-14.7	-9.4	7.5	3.8
Beverages	-5.8	7.9	-17.7	-23.4	-16.9	1.5	4.3
Raw materials	-0.4	1.9	-23.2	1.4	3.7	4.2	3.5
Metals and minerals	0.6	-1.5	-16.2	-2.3	13.6	2.2	1.6
Fertilizers	-2.5	2.6	2.0	-6.6	-6.3	4.7	1.1
<i>Memorandum item</i>							
G-5 manufactures unit value	3.3	1.1	-1.9	-2.7	-2.3	3.6	2.2

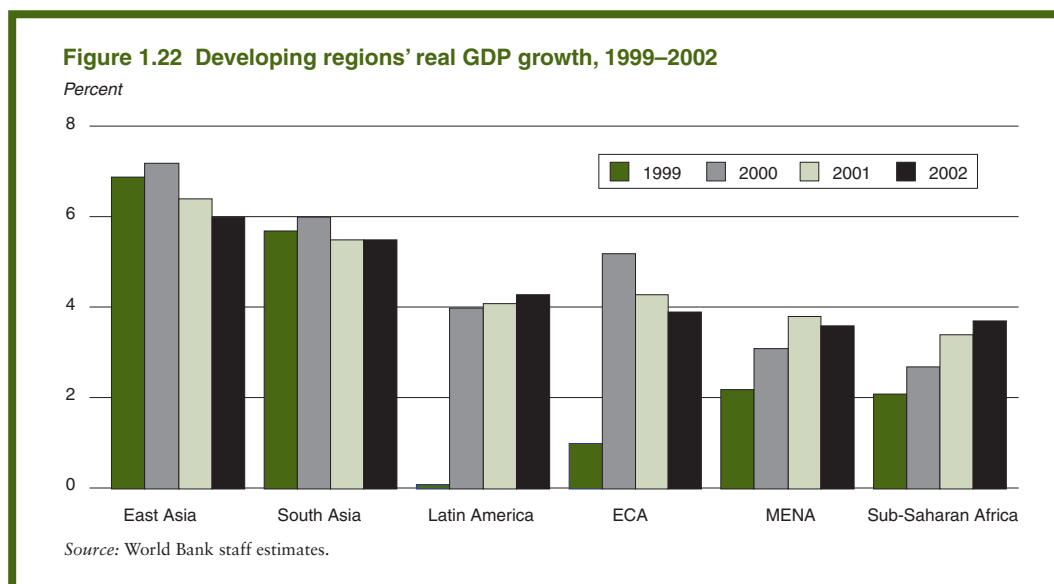
Note: The G-5 countries are France, Germany, Japan, the United Kingdom, and the United States.  
Source: World Bank data and projections update, November 2000.

grown most rapidly, population growth will be even slower. This may be partially offset by faster growth of world real incomes (projected at 3.4 percent over 2000–10 compared to 2.7 percent during the 1990s). However, since income elasticities of demand for commodities are low, the overall impact of more rapid income growth on commodities will be small.

## Developing countries' recovery is unexpectedly rapid, and prospects for long-term growth have improved

Developing countries' recovery from the 1997–98 financial crisis at 5.3 percent growth has been faster and much stronger than anticipated.<sup>20</sup> All regions have experienced





stronger growth in 2000, although there has been diversity across regions. Contributing factors include easier monetary policies in the industrial countries and in East Asia, which lowered interest rates and stimulated domestic demand; the depreciation of many developing countries' currencies, which boosted exports; and more recently the rise in oil prices, which has supported economic activity in some of the economies hit by the crisis or in those near crisis (such as Indonesia, Nigeria and the Russian Federation). Industrial production in most of the crisis-affected countries of East Asia rebounded at double-digit growth rates in late 1999 and into 2000. Latin America also is recovering sharply, albeit at a slower rate than in the wake of the Mexican peso crisis. And Russian growth (a large segment of the growth in the Europe and Central Asia region) was unexpectedly strong, boosted by oil revenues (figure 1.22 and table 1.5). China and India continue to exhibit sustained rapid growth, and Middle Eastern countries are benefiting from high oil prices and recovery in the Euro Area. Even the non-oil exporters in Sub-Saharan Africa increased GDP by 3.2 percent, despite low non-oil commodity prices. Altogether, developing countries' GDP is expected to increase

by 5.3 percent in 2000, matching peak years 1983 and 1997. Inflation came down quickly following the crisis (when sharp exchange rate depreciations led to rapid price rises in several countries) and remains moderate despite the spike in oil prices. Despite this favorable picture, financial tensions are building up once again in East Asia and Latin America. The decline in stock markets and the recent increase in spreads make several countries vulnerable in the short run. The risks associated with these vulnerabilities are explored later in this chapter where the possibilities of a strong global downturn are discussed. The baseline forecast, however, features a moderate slowdown from the cyclical peak in early 2000. With this moderate deceleration, all developing regions are expected to enjoy near-term increases in per capita income, ranging from nearly 6 percent in East Asia to about 1.5 percent in the Middle East and North Africa and Sub-Saharan Africa.

*Payoffs to domestic reforms and improved external conditions favor long-term growth*  
The cyclical recovery is expected to be followed by an acceleration of long-term growth, although the outlook varies considerably across regions (figure 1.23). Population growth in the

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**Table 1.5 Growth of World GDP, 1998–2002**

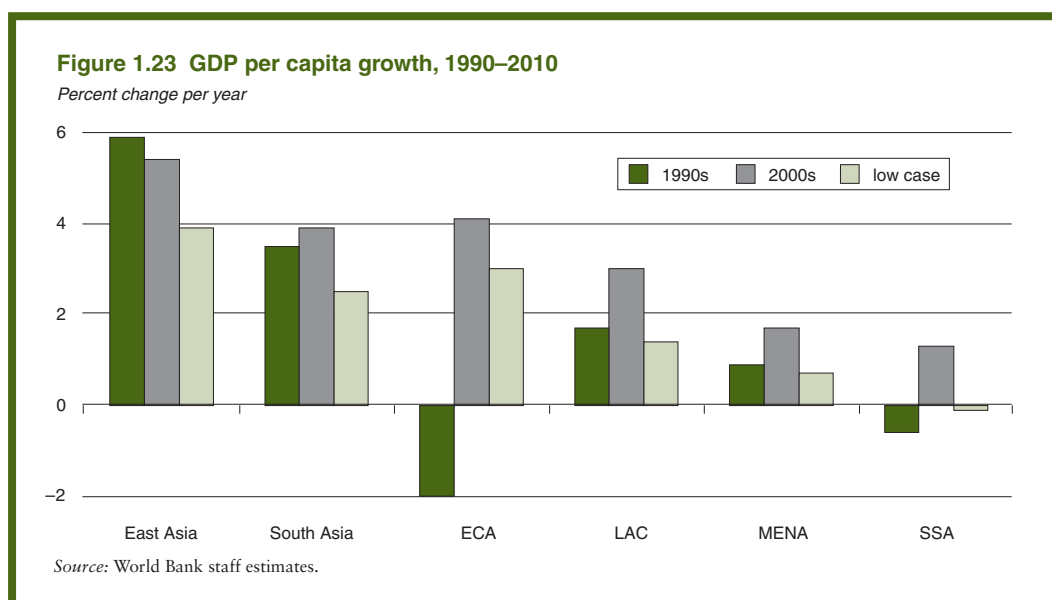
(percentage change in real GDP)

	1998	1999	Forecast		
			2000	2001	2002
<b>World total</b>	1.9	2.8	4.1	3.4	3.2
<b>High-income countries</b>	2.1	2.7	3.8	3.0	2.8
OECD	2.1	2.7	3.7	2.9	2.7
United States	4.4	4.2	5.1	3.2	2.9
Japan	-2.5	0.3	2.0	2.1	2.2
Euro Area	2.7	2.4	3.4	3.2	2.8
Non-OECD countries	0.7	4.2	6.3	5.1	5.1
<b>Developing countries</b>	1.0	3.2	5.3	5.0	4.8
East Asia and Pacific	-1.4	6.9	7.2	6.4	6.0
Europe and Central Asia (ECA)	0.0	1.0	5.2	4.3	3.9
Latin America and the Caribbean	2.0	0.1	4.0	4.1	4.3
Middle East and North Africa	3.3	2.2	3.1	3.8	3.6
South Asia	5.6	5.7	6.0	5.5	5.5
Sub-Saharan Africa	2.0	2.1	2.7	3.4	3.7
<i>Memorandum items</i>					
East Asia-5 countries <sup>a</sup>	-8.2	6.7	6.9	5.5	5.1
Transition countries of ECA	-0.7	2.5	5.0	4.2	3.7
Developing countries					
Excluding the transition countries	1.2	3.3	5.3	5.1	5.0
Excluding China and India	-0.6	2.2	4.7	4.4	4.5

Note: All countries listed in the “Classification of Economies” section at the end of this report are included as components of the regions presented in Tables 1.5 and Table 1.6 (as well as the world summary table (Table 1.1)). Exceptions, for which sufficient historical data or projections are unavailable include: 11 low-income countries (among which, Armenia, Honduras and Nicaragua); 7 middle-income countries (among which, Iraq, Georgia, Guyana), and 2 high-income countries (Cyprus, Iceland).

a. Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.

Source: Development Prospects Group, baseline, October 2000.



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developing world is slated to slow from 1.6 percent annually in the 1990s to 1.3 percent during 2000–10. And output per capita in developing countries is projected to rise by 3.7 percent per year over the next decade, more than double the 1990s rate, in large part reflecting the turnaround from output declines in the transition economies (table 1.6). Other developing regions are expected to achieve more modest increases in growth rates. External conditions are assumed to be more favorable than during the 1990s, as higher productivity-led per capita growth in industrial countries (2.6 percent versus 1.9 percent, respectively) and further progress in trade liberalization should support the growth of demand for developing-country exports at high levels. And capital flows to developing countries should resume within an environment of low inflation and low interest rates.

It is important to note that developing countries all over the world are expected to

reap the benefits of reforms carried out over the past decade (selected indicators are highlighted in table 1.7). In effect, these factors constitute the initial conditions from which longer-term prospects may be drawn. A number of clear improvements can be discerned. Median inflation rates have been halved, and central government budget deficits are lower now than in the late 1980s, contributing to improved investor confidence. And developing countries are much more open now than they were 10 years ago, as trade liberalization and stronger trade growth has helped raise trade to GDP ratios by 50 percent on average. In addition, better policies have attracted FDI (which increased from 0.5 percent of developing countries' GDP in 1988–90 to 2.7 percent in 1998–2000). Moreover, rapid growth in exports facilitated a significant decline in debt-to-export ratios compared with the late 1980s.

Many developing countries have made substantial investments in human capital. For ex-

**Table 1.6 Growth of World GDP per capita, 1980s through 2010**

(annual average percentage change)

	1980s	1990s	Forecast		Difference in growth rates
			Baseline 2000–2010	Low case 2000–2010	
<b>World total</b>	1.3	1.3	2.3	1.3	-1.0
<b>High-income countries</b>	2.4	1.9	2.7	1.7	-1.0
OECD	2.4	1.9	2.6	1.6	-1.0
United States	2.2	2.3	2.5	1.2	-1.3
Japan	3.4	1.1	2.3	1.0	-1.3
Euro Area	2.1	1.9	3.0	2.4	-0.6
Non-OECD countries	3.7	3.7	4.1	2.3	-1.8
<b>Developing countries</b>	0.8	1.8	3.7	2.3	-1.4
East Asia and Pacific	5.6	5.9	5.4	3.9	-1.5
Europe and Central Asia (ECA)	0.4	-2.0	4.1	3.0	-1.1
Latin America and the Caribbean	-0.9	1.7	3.0	1.4	-1.6
Middle East and North Africa	-0.6	0.9	1.7	0.7	-1.0
South Asia	3.5	3.5	3.9	2.5	-1.4
Sub-Saharan Africa	-1.2	-0.6	1.3	-0.1	-1.4
<i>Memorandum items</i>					
East Asia-5 countries <sup>a</sup>	4.4	3.5	4.2	2.9	-1.3
Transition countries of ECA	0.3	-2.6	4.1	3.1	-1.0
Developing countries					
Excluding the transition countries	1.3	3.0	3.7	2.2	-1.5
Excluding China and India	0.0	0.5	2.9	1.6	-1.3

a. Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.

Source: Development Prospects Group, baseline and low-case, October 2000.

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**Table 1.7 Forecast assumptions: developing countries**

Initial conditions	1988–90	1998–2000
1. Ratio of real GDP per capita: industrial / developing countries	19.5	20.5
2. Trade (X+M) / GDP ratio (real)	29.0	43.5
3. Median Inflation rate	12.6	6.1
4. Median Fiscal Balance / GDP	-2.7	-1.8
5. Investment / GDP (real)	23.1	24.3
6. Investment / GDP (nominal)	25.6	24.3
7. Gross National Savings / GDP	25.2	23.3
7a. Gross Domestic Savings / GDP	27.1	25.1
8. Current account balance / GDP	-0.7	-0.8
9. FDI / GDP	0.5	2.7
10. External DOD / Exports*	172.6	142.2
11. School enrollment rates		
Primary	78.0	82.0
Secondary	56.0	63.0
12. Illiteracy rate	31.0	26.0
13. Under-5 mortality rate	91.0	79.0
14. Life expectancy	63.0	65.0
Exogenous assumptions	1990s	2001–10
1. Population growth	1.6	1.3
2. OECD GDP growth	2.4	2.9
3. Oil price \$ per barrel (avg.)	18.2	20.2
4. World trade growth	6.5	6.8

\*Exports of goods and services plus workers remittances.

Note: Real indicators use 1995 as base year.

Source: World Bank database, DECPG staff estimates.

ample, school enrollment rates are substantially higher than in the late 1980s, and illiteracy rates fell from 31 percent in 1990 to 26 percent in 1998. And health indicators show improvement: under-five mortality rates dropped from 91 per 1,000 live births to 79, and life expectancy has increased from 63 years to 65 years. These developments suggest that newcomers to the labor force should be better educated and more capable of working than those who retire—a positive development for absorption of new technologies and for innovation. With real per capita incomes today still only one-twentieth that of the industrial countries, developing countries that remain open to trade and FDI can achieve higher rates of growth through maximizing the new technology and skills embodied in these flows.

*East Asia.* On average, output in the five countries most affected by the financial crisis (Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand) recovered smartly in

1999 at a rate of 6.7 percent in contrast with their 1998 crisis decline of 8.2 percent. They consolidated further with growth near 7 percent in 2000. A low-inflation, low-interest-rate environment has been particularly beneficial to the process of unwinding the domestic debt problems faced by firms and consumers in these crisis countries. Corporate and financial restructuring and rehabilitation of the financial sectors are being pursued, though perhaps at a slower pace than warranted. The slow pace could be a detrimental factor to near term growth, if interest rates rise rapidly or demand falters leading to diminished cash flow. Robust export growth and firming export prices have helped maintain a positive current account balance. Though the recovery of imports and higher oil prices have narrowed the balance in many countries, rising reserves and the improved term structure of foreign debt have strengthened external positions vis-à-vis pre-crisis levels.

Growth in China during the postcrisis period has ranged between 7 and 8 percent. A falloff in export growth, combined with the short-term impact of reform programs for the state enterprises and the financial system, led initially to a drop in domestic demand and a period of deflation. The real depreciation of the yuan, coupled with the global recovery, eventually led to a resurgence of exports. Combined with fiscal pump priming, and an incipient increase in FDI, export growth has produced improving conditions in China, with GDP growth accelerating in the first half of 2000 and the deflationary cycle ending. In 2001–02, output for the East Asia region is likely to begin a general process of moderating and converging toward longer-term growth paths. The two most vulnerable countries are Indonesia and the Philippines. These countries also suffer from political weaknesses, civil disturbances, and a perception (from the point of view of investors) that business operating practices have not changed substantially from less than transparent modes.

East Asia should continue to achieve the most rapid rates of growth over the longer term, although some deceleration from the

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GLOBAL ECONOMIC PROSPECTS

last decade's pace is likely. Growth in the region's higher-income economies is expected to converge toward more moderate OECD average rates. Lower-income countries that have achieved high growth rates through strong reform programs may find the future reform agenda (particularly strengthening the financial sector) more difficult to implement.

*South Asia.* GDP growth in South Asia has risen to 5.7 percent in 1999 and is likely to register 6 percent in 2000, owing to better than expected agricultural sector performance in Bangladesh, India, and Pakistan, as well as an acceleration of India's industrial production to double-digit rates and strong advances in services output. Burgeoning foreign demand for IT-related services from Bangalore and a pickup of FDI inflows (\$2.2 billion in 1999) are major factors underlying India's improved export performance. To facilitate the growth of Indian services exports, legislation has been introduced to support the IT sector and develop electronic business infrastructure. Average growth for the region is expected to slow to 5.5 percent in 2001–02. Financial difficulties are likely to restrain growth in Pakistan. In addition, the region is heavily dependent on energy imports and (especially in the case of the smaller countries) on agricultural exports such as cotton, tea, and rubber. The necessity of adjusting to terms-of-trade losses from the recent, adverse movements in primary commodity prices may dampen growth in the near term. By contrast, South Asian economies may raise per capita growth rates in the long term if they can manage to reduce fiscal deficits (while still maintaining growth-enhancing expenditures) and make necessary progress in trade liberalization. For example, India's average tariff for all goods, while considerably reduced from that of 10 years ago, remains at 40 percent.

*Latin America's* GDP is expected to rise by 4 percent in 2000, although the dispersion of growth across the region is wide, ranging from over 6 percent in Mexico and Chile to nearly 2 percent in Colombia and Uruguay, and to little growth in Argentina, Ecuador and Jamaica. Stabilization of global financial markets and

the surge of world trade growth have supported a broad resumption of economic activity across the region. At the same time, inflation eased or held steady in most countries, allowing interest rates to continue on a general declining trend. Exchange rates stabilized in several countries that experienced periods of free fall during 1999 (for example, Brazil and Ecuador), improving the outlook for domestic demand growth, especially in Brazil.

Global conditions are expected to be more supportive of growth in the region over the next two years. However, recent experience suggests that volatility in financial markets and primary commodity prices remains a substantial threat to near-term recovery. Private capital inflows fell dramatically in the second quarter of 2000, tied to the worldwide decline in equity markets, and the recovery in industrial production among the large countries of the region appeared to have faltered. The surge in the price of oil, concomitant with weakness in commodity prices of critical importance to the region (particularly the prices of coffee, grains, and soybeans) produced terms-of-trade losses for a large number of countries. Nonetheless, consolidation of the region's recovery in 2001–02 is likely, as adjustment in Brazil has been impressive so far, and new governments in Argentina and Mexico appear set to embark on a path of deepened reforms. Regional output growth is expected to reach 4.1 percent in 2001 and to rise further to 4.3 percent in 2002.

Latin America is poised to enter a phase of sustained moderate growth over the next decade that is due to the past trend toward market-friendly policies in the larger countries; relatively strong banking and financial sectors; potential for technology spillovers from the United States; the largest rise in FDI among developing regions (much of which went into infrastructure such as telecommunications, utilities, ports, and so forth); and the potential strengthening of Mercosur through trade links with Europe and NAFTA. But low national savings and large debt overhangs that will need to be rolled over on a continuing basis make the region vulnerable to swings in

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PROSPECTS FOR DEVELOPING COUNTRIES AND WORLD TRADE

external financing and are likely to constrain growth below the rates expected in Asia.

*Europe and Central Asia.* Average GDP growth is expected to rise to 5.2 percent in 2000, significantly above the 1 percent advance of 1999. The 50 percent rise in oil and gas prices has transformed the Russian primary fiscal position from deep deficit to surplus, allowing reductions in government wage arrears and contributing to higher disposable incomes.<sup>21</sup> Moreover, Russian industry continues to benefit from the sharp devaluation of August 1998, although import-substitution effects are diminishing with the recent real appreciation of the ruble. Higher energy prices and economic spillovers from the Russian Federation are contributing to stronger output growth among hydrocarbon-rich members of the Commonwealth of Independent States (CIS). The Central and Eastern European countries (CEECs) and the Baltic countries are benefiting from growing demand from Western Europe and to a lesser degree from the Russian Federation.<sup>22</sup> Growth in Turkey is approaching 6 percent in 2000, up from the sharp 5.1 percent contraction in 1999, principally because of a rebound domestic demand linked to declines in real interest rates.

Growth performance for the region through 2002 is expected to remain relatively strong in aggregate, stabilizing around 4 percent. Developments in the EU export market, policy implementation related to EU accession for the CEECs, and the path of the oil price will be critical factors in shaping the outlook. The Russian Federation and other hydrocarbon exporters of the CIS may experience a slowing of growth beginning in 2001, as oil prices retreat from current high levels. The region's longer-term prospects have improved considerably after the difficulties experienced during the initial period of transition to market economies in the 1990s. Countries anchored by the EU accession process have strong incentives to implement reforms and are positioned for stronger growth than other countries in the region. The baseline assumes improved economic management and some progress in implementing recently proposed social and economic reforms in the Rus-

sian Federation, while the trajectory of growth in world trade and output should support steady gains in other CIS states.

*Sub-Saharan Africa.* Fallout from the 1997–99 crisis continued to exert a depressing effect on the region in 2000, as non-oil commodity prices remained near cyclical lows. But higher oil revenues boosted growth for the region's oil exporters, and output in South Africa strengthened moderately to 2.2 percent growth following several years of subdued performance. On average, the region experienced an acceleration of growth to 2.7 percent from 2.1 percent in 1999, and per capita income gained an average of 0.2 percent. Countries with better policy environments—Botswana, Uganda, and several countries of the Communauté Financière Africaine (CFA) zone—tended to perform better than average, with GDP gains of 5.2 percent. Countries experiencing civil strife or major political disruption—Angola, the Democratic Republic of Congo, Ethiopia, Sierra Leone, and Zimbabwe—registered the weakest performances, averaging only 0.2 percent growth during the year.

Growth is projected to accelerate to 3.4 percent in 2001 and 3.7 percent in 2002. Oil producers, including Angola, Nigeria, and Sudan, are scheduled to bring further supply on-stream, while continued high prices through 2001 should abet revenue growth. The terms of trade for commodity exporters should stabilize or improve moderately from their current low levels as non-oil commodity prices firm. The HIPC (Heavily Indebted Poor Countries) Initiative is gaining momentum, with nine African countries—Benin, Burkina Faso, Cameroon, Mali, Mauritania, Mozambique, Senegal, Tanzania, and Uganda—now having qualified for a total of close to \$9 billion (NPV) of relief. And several more countries are expected to reach completion points in the near term. The enhanced HIPC Initiative is worth nearly \$30 billion in net present value terms, with some 80 percent of the program earmarked for Sub-Saharan Africa.

Progress in reform programs and in debt-relief has improved the prospects for growth. Per capita income is projected to rise by 1.3

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percent per year over the next decade. This prospect is far better than the decline that continued over the 1990s, but the increase is only one-third the average rate of Asian economies. Economies in Sub-Saharan Africa will continue to confront the severe problems of poor transport and communications infrastructures, a lack of investor confidence that encourages capital flight and constrains private investment rates, and continued low levels of official assistance. It is important to realize that HIV/AIDS will have a substantial negative impact on a number of countries. According to estimates by UNAIDS (2000), Sub-Saharan Africa contains 24.5 million (or 70 percent) of the 34.3 million existing cases worldwide and 12.1 million of a total of 13.2 million AIDS orphans. In the longer term, lower human capital accumulation may well emerge as the biggest cost, and in the worst-affected countries, labor force growth could slow by 1 or 2 percentage points, with a depressing effect on growth.

*Middle East and North Africa.* Developments for both oil exporters and diversified exporters in the region have been quite favorable, with GDP growth of 2.2 percent reported in 1999 and growth of 3.1 percent anticipated for 2000. Many of the major oil producers had formulated budgets around an assumed oil price of \$22 per barrel, and higher revenues have contributed to lower borrowing requirements, lower deficits, and a decline in domestic arrears. Strong growth in Western Europe has fueled a boom in tourism, with record numbers of tourist arrivals in many North African and Mediterranean countries. The economic revival in Europe has also led to stronger gains in non-oil exports and workers' remittances. For example, remittance flows to Tunisia rose by 75 percent during 1999. And the ending of drought conditions in many countries boosted agricultural incomes and exports and led to declines in required food imports.

Activity is expected to pick up moderately to 3.8 percent in 2001 and 3.6 percent in 2002. With an average oil price of \$25 per barrel for 2001 and \$21 in 2002, export revenues should continue to support income

growth in the oil exporters. For the diversified exporters, the positive effects of higher external demand are being counterbalanced by relatively strong currencies, high fiscal deficits in Egypt and Lebanon, as well as recent declines in stock markets. Moreover, the ongoing nature of recent conflict in the Levant may also have dampening effects on confidence in the rest of the MNA region.

Progress in structural reforms and improved fiscal behavior with respect to commodity price booms and busts should support some acceleration of per capita growth over the next decade. However, large and inefficient public sectors, a shortage of social safety nets, and low savings and private investment rates should limit growth rates to well below those of most other regions. Moreover, without more substantial diversification of production, these economies will remain exposed to unfavorable terms-of-trade shocks.

## Vulnerabilities are significant

While the baseline scenario of solid growth in all regions is realistic and achievable, history cautions that cyclical downturns or crises induced by commodity or financial shocks are difficult to anticipate. To explore the implications of less favorable outcomes, a low-case scenario has been developed that combines a downturn of the global economy in the short run with lower potential growth rates in the long run. In the short run, continued high oil prices especially characterized by short-lived "spikes," contribute to inflationary pressures and increased uncertainty, triggering serious cuts in demand and restrictive monetary policies. Additionally, investor concern over the high U.S. current account deficit leads to a rapid reversal of foreign funds and a large stock market correction, while the associated fall in demand, depreciation of the dollar, and rise in interest rates have significant spillovers to other regions through trade, capital flows, and debt service. The East Asian countries, in process of financial restructuring, would be particularly affected. The ensuing global re-

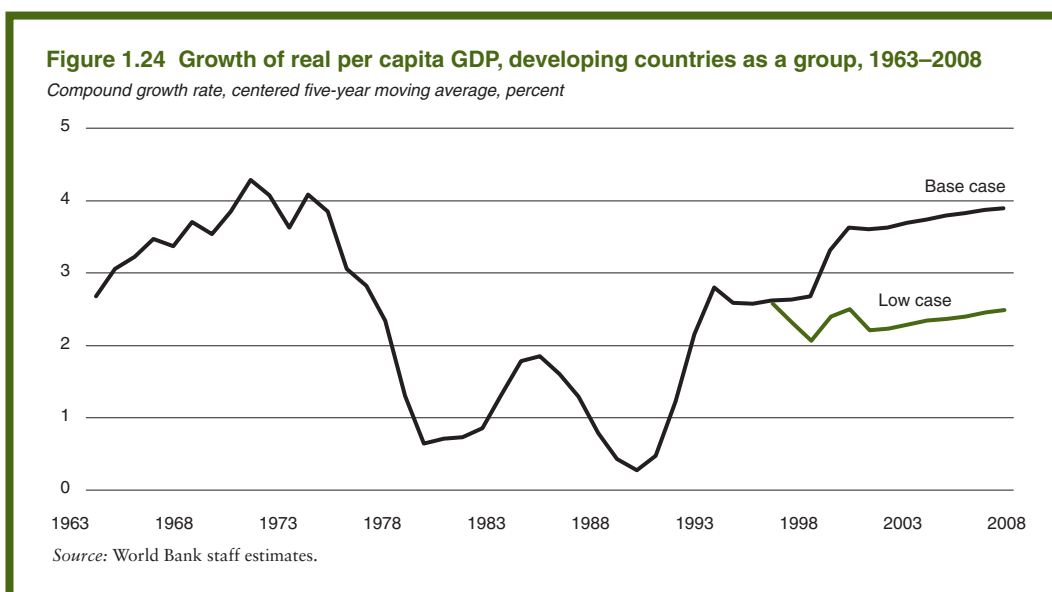
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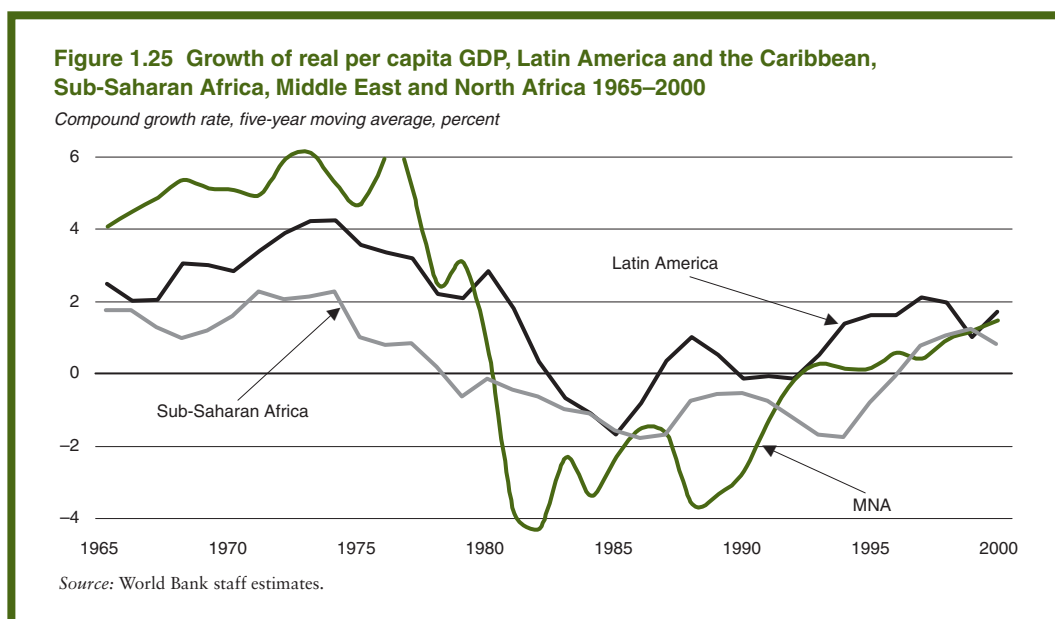
cession exacerbates the strains inherent in rapid globalization and structural adjustment, leading to a hold on reform programs that slows expected gains in productivity leading to long-term growth. On average, these elements bring down the potential growth rate of the developing countries as a group by almost 1.5 percentage points over the period to 2010 (table 1.6 and figure 1.24).

The implications of the short-term global recession differ greatly across developing regions. Latin America, with high levels of debt and relatively high dependence on exports to the United States, is hit hardest by the global downturn and the higher interest rates. East Asia, which has a similar export orientation toward the United States, is directly hurt by the fall in U.S. demand, the depreciation of the dollar, and mounting domestic financial difficulties. Central and Eastern Europe, the Middle East and North Africa and Sub-Saharan Africa, all with a stronger focus on Europe, experience a more moderate downturn in the short run, as the growth slowdown in Europe is not as severe as in the United States. In South Asia, the impact of the global downturn is diverse. As during earlier crises, India exhibits some resilience to less favorable external de-

velopments, while for Pakistan the worsening of international financial conditions has very severe consequences.

Since the structural risks are mainly of domestic origin, they are by nature quite differentiated across countries. Nevertheless, there are some common elements that follow from past trends in the regions. Sub-Saharan Africa and the Middle East and North Africa are at the end of two decades of stagnation or decline, while growth in Latin America has picked up from the “lost decade” of the 1980s (figure 1.25). Reform programs in many of these countries have greatly improved the conditions for growth. However, high indebtedness and the fragility of the reforms make these regions very vulnerable to adverse global conditions, especially a rapid rise in interest rates. The main risk for the oil-importing countries in these regions is that a global downturn, combined with a deterioration of the terms of trade and a lack of immediate improvements, could bring about social unrest and “reform fatigue.” For oil exporters, the danger is that the temporary surge in oil revenues might suggest that reform is not urgent anymore. Such a reversal of the reform momentum in both oil-exporting and oil-importing countries could reduce the growth





potential for the coming decade. And in Sub-Saharan Africa, diminished government revenues tied to terms-of-trade losses could make HIV/AIDS prevention and alleviation campaigns more difficult, further increasing economic losses associated with the epidemic.

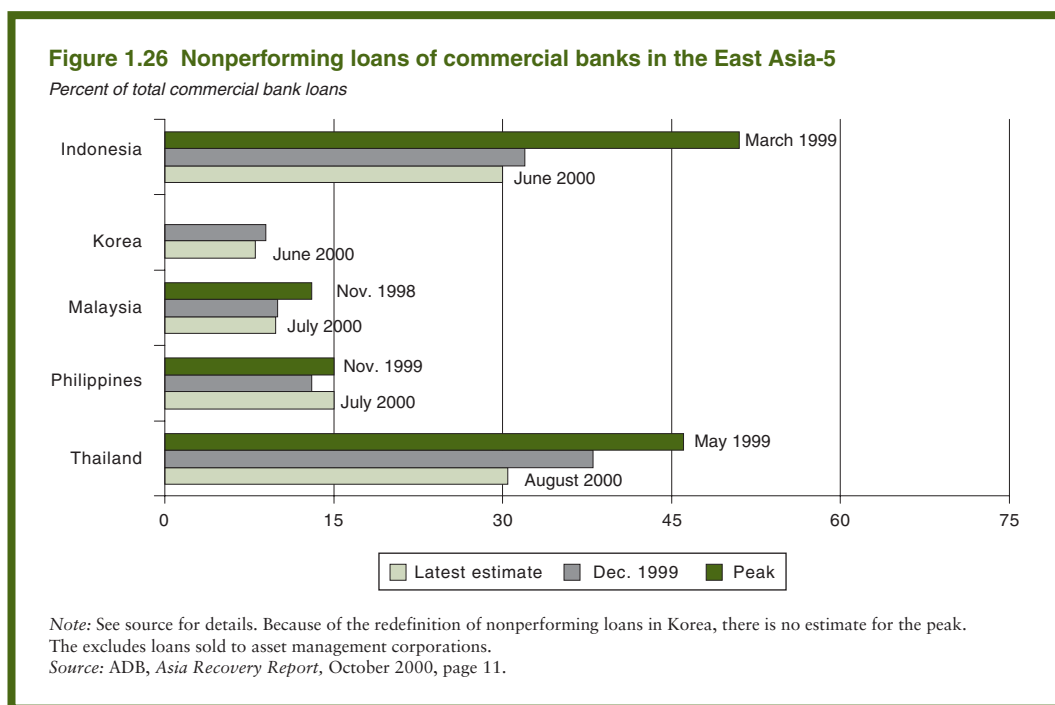
In Asia, by contrast, many countries achieved rapid rates of growth through strong reform programs during the 1980s and 1990s. Nevertheless, continued rapid growth in the larger countries requires further reforms, including trade liberalization (in China measures related to WTO accession, in India reduction of high existing tariffs), strengthening of the financial sector (through much of East Asia), (figure 1.26) and strengthening of the fiscal position in India. In the alternative scenario, a backlash to reform programs reduces the long-term growth potential in Asia by about 1.5 percentage points a year.

The transition economies experience some weakening of reform momentum that lowers long-term productivity, without repeating the disastrous experience of the 1990s. Central European countries' accession to the European Union is postponed because the global downturn reduces growth in Europe and increases the perceived costs of accession. For Central

Europe, this increases domestic tensions and reduces FDI flows, bringing down trend growth. The oil-exporting countries in the CIS experience a delay of necessary reforms, similar to the delay in the Middle Eastern and North African oil exporters. When, ultimately, the oil price declines quickly as a result of the economic downturn, the lack of reforms translates into lower potential growth.

### Recent trends and prospects for poverty reduction

**P**overty trends during the 1990s. Our estimates for poverty in developing countries have changed slightly since last year's *Global Economic Prospects* because of the availability of new information from household surveys. These revisions do not affect the major conclusions about poverty trends. Extreme poverty declined only slowly in developing countries during the 1990s: the share of the population living on less than \$1 a day fell from 28 percent in 1987 to 23 percent in 1998, and the number of poor people remained roughly constant as the population increased.<sup>23</sup> The share and number of people living on less than



\$2 per day—a more relevant threshold for middle-income economies such as those of East Asia and Latin America—showed roughly similar trends (tables 1.8 and 1.9).

It should be emphasized that these historical estimates are subject to some uncertainty. Up-to-date survey and price data are not available for all countries, and the quality of household surveys can vary considerably among countries and over time. Some country surveys yield income measures of living standards, while others yield consumption measures, and these two sources are likely to give different poverty estimates for the same underlying population.<sup>24</sup> Further, the international measure of poverty used here is subject to error because of the difficulties involved in estimating purchasing power parity exchange rates. Despite these weaknesses, the estimates provide a fairly reliable view of poverty trends at the aggregate level, because of the substantial increases in the coverage of household surveys and in data accuracy over the past few years.

In general, poverty declined in countries that achieved rapid growth, and increased in

countries that experienced stagnation or contraction. Indeed, the overall decline in extreme poverty during the 1990s was driven by high rates of growth in countries with large numbers of poor people. For example, China accounted for a fourth of the total number of poor at the start of the decade, and per capita GDP during the 1990s rose by 9 percent per year, so by 1998 China's share of the world's poor was less than one-fifth. Nevertheless, the decline in poverty in rapidly growing countries was slowed by increases in inequality in a number of countries with large numbers of poor, in particular in China, India, Bangladesh, and Nigeria.<sup>25</sup> Income inequality is an important factor in determining poverty outcomes (box 1.3).

In East Asia, poverty declined most rapidly during the 1990s, falling sharply in China. However, growth in China's poorer and more rural western provinces was much slower than in the more industrialized east. This divergence reflects slow growth in rural incomes related to declining prices for agricultural products and reduced opportunities for off-

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**Table 1.8 Population living on less than \$1 per day and headcount index in developing countries, 1987, 1990, and 1998**

Region	Population covered by at least one survey (percent)	Number of people living on less than \$1 a day (millions)			
		1987	1990	1998 new	1998 (GEP 2000)
East Asia and Pacific	90.8	417.5	452.4	267.1	278.3
Excluding China	71.1	114.1	92.0	53.7	65.1
Europe and Central Asia	81.7	1.1	7.1	17.6	24.0
Latin America and the Caribbean	88.0	63.7	73.8	60.7	78.2
Middle East and North Africa	52.5	9.3	5.7	6.0	5.5
South Asia	97.9	474.4	495.1	521.8	522.0
Sub-Saharan Africa	72.9	217.2	242.3	301.6	290.9
Total	88.1	1,183.2	1,276.4	1,174.9	1,198.9
Excluding China	84.2	879.8	915.9	961.4	985.7

Region	Population covered by at least one survey (percent)	Headcount index (percent)			
		1987	1990	1998 new	1998 (GEP 2000)
East Asia and Pacific	90.8	26.6	27.6	14.7	15.3
Excluding China	71.1	23.9	18.5	9.4	11.3
Europe and Central Asia	81.7	0.2	1.6	3.7	5.1
Latin America and the Caribbean	88.0	15.3	16.8	12.1	15.6
Middle East and North Africa	52.5	4.3	2.4	2.1	1.9
South Asia	97.9	44.9	44.0	40.0	40.0
Sub-Saharan Africa	72.9	46.6	47.7	48.1	46.3
Total	88.1	28.3	29.0	23.4	24.0
Excluding China	84.2	28.5	28.1	25.6	26.2

*Note:* The \$1 a day is in 1993 purchasing power parity terms. The numbers are estimated from those countries in each region for which at least one survey was available during the period 1985–98. The proportion of the population covered by such surveys is given in column 1. Survey dates often do not coincide with the dates in the above table. To line up with the above dates, the survey estimates were adjusted using the closest available survey for each country and applying the consumption growth rate from national accounts. Using the assumption that the sample of countries covered by surveys is representative of the region as a whole, the numbers of poor are then estimated by region. This assumption is obviously less robust in the regions with the lowest survey coverage. The head count index is the percentage of the population below the poverty line. Further details on data and methodology can be found in Chen and Ravallion 2000.

*Source:* World Bank staff estimates.

farm employment. This widening of income inequality slowed the rate of poverty reduction for the country as a whole.<sup>30</sup> Elsewhere in the region, poverty increased in the aftermath of the 1997–98 financial crisis. In Indonesia, the government responded to the crisis by strengthening safety nets, which helped cushion the impact of the crisis. However, the incidence of poverty still increased substantially, doubling from its precrisis level. Since early 1999, there have been indications that poverty has declined significantly as rice prices have fallen, and real wages are starting to recover (Suryahadi and others 2000).

In **South Asia**, the share of the population living in poverty declined moderately through the 1990s, but not sufficiently to reduce the absolute number of poor. Household survey data indicate limited growth in average consumption in rural areas, reflecting slow growth in agriculture.<sup>31</sup> Urban poverty appears to have declined at twice the rate of poverty in rural areas. However, the Indian poverty data are subject to considerable uncertainty. In particular, private consumption as measured in the national accounts has grown about three times faster over the 1990s than household consumption as measured by the National

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**Table 1.9 Population living on less than \$2 per day and head count index in developing countries, 1987, 1990, and 1998**

Region	Population covered by at least one survey (percent)	Number of people living on less than \$1 a day (millions)			
		1987	1990	1998 new	1998 (GEP 2000)
East Asia and Pacific	90.8	1,052.3	1,084.4	884.9	892.2
Excluding China	71.1	299.9	284.9	252.1	260.1
Europe and Central Asia	81.7	16.3	43.8	98.2	92.9
Latin America and the Caribbean	88.0	147.6	167.2	159.0	182.9
Middle East and North Africa	52.5	65.1	58.7	85.4	62.4
South Asia	97.9	911.0	976.0	1,094.6	1,095.9
Sub-Saharan Africa	72.9	356.6	388.2	489.3	474.8
Total	88.1	2,549.0	2,718.4	2,811.5	2,801.0
(excluding China)	84.2	1,796.6	1,918.8	2,178.7	2,168.9

Region	Population covered by at least one survey (percent)	Headcount index (percent)			
		1987	1990	1998 new	1998 (GEP 2000)
East Asia and Pacific	90.8	67.0	66.1	48.7	49.1
Excluding China	71.1	62.9	57.3	44.3	45.0
Europe and Central Asia	81.7	3.6	9.6	20.7	19.9
Latin America and the Caribbean	88.0	35.5	38.1	31.7	36.4
Middle East and North Africa	52.5	30.0	24.8	29.9	21.9
South Asia	97.9	86.3	86.8	83.9	84.0
Sub-Saharan Africa	72.9	76.5	76.4	78.0	75.6
Total	88.1	61.0	61.7	56.1	56.0
Excluding China	84.2	58.2	58.8	57.9	57.6

Note: The \$2 a day is in 1993 purchasing power parity terms. See the note to table 1.8.

Source: World Bank staff estimates.

Sample Survey. Discrepancies are to be expected, as the two sources track different aggregates.<sup>32</sup> Moreover, the survey data tend to understate the consumption of high-income households. Nevertheless, the size of this difference and the slowness of poverty reduction revealed in the survey data are difficult to account for, particularly given the improvement in human development indicators. Thus more accurate data could indicate more rapid poverty reduction than our current estimates. In Bangladesh, steady growth reduced the incidence of poverty during the 1990s, in contrast to the relative stagnation experienced in the 1980s. Poverty in urban areas fell at a considerably faster rate than rural poverty, partly reflecting slower growth in rural wages and higher rural unemployment. Landlessness has

been key in holding back the reduction of poverty in rural areas.<sup>33</sup>

In **Latin America**, both the share and the number of poor declined between 1990 and 1998. In Brazil, successful stabilization has stepped up the reduction of poverty, with the poor gaining from stronger growth and the decrease in inflation. Nonetheless, their livelihoods remain vulnerable. Evidence from employment surveys in metropolitan areas shows large swings in poverty, with an upturn in the poverty rate in the wake of the 1997–99 crisis and a decrease since late 1999, thanks to the rebound in growth. Low educational attainment has helped to perpetuate income inequality and poverty by preventing the poor from taking advantage of opportunities created by growth (World Bank 2000a).

### Box 1.3 Trends in inequality

Countries with high levels of initial inequality have reduced poverty less for given rates of growth than countries with low initial inequality (World Bank 2000d), and if growth is accompanied by increasing inequality, its impact on poverty will be reduced. However, our understanding of long-term trends in inequality is limited, partly because of weaknesses in the data.<sup>26</sup> Trends in inequality have been extremely diverse. For example, Malaysia saw declines in inequality (as measured by the Gini coefficient) during the 1980s, but this trend was reversed in the 1990s. Korea and Indonesia experienced rapid growth during the 1980s with little change in inequality, while China and Russia experienced large increases in inequality over the same period.

The available data show no stable relationship between growth and inequality.<sup>27</sup> On average, income inequality within countries has neither decreased nor increased over the last 30 years. However, since within-country inequality has increased in some populous countries, overall more people have been affected by increases in inequality than by decreases.

What drives inequality? Here, too, our knowledge is limited. Nevertheless, both cross-country analyses and case studies have generated insights into the link between inequality and several policy and institutional factors.

- Policies fostering stable macroeconomic conditions, openness to trade, and moderate size of government tend to stimulate growth but have been found in one study not to systematically affect the distribution of income (Dollar and Kraay 2000). However, policies that reduce inflation from very high levels appear to benefit the poor more than the average.
- If growth is strong in areas where the poor live and sectors where they are employed (for example,

smallholder agriculture), they benefit more; if growth takes place in areas or sectors that are not accessible to the poor, inequality can increase. Domestic policy distortions that hinder agriculture (along with international trade barriers) have restrained growth in rural incomes in many countries. This has also been reflected in rising regional inequality, as in poor regions farming is often the dominant sector of activity.<sup>28</sup>

- Changes in income inequality reflect changes in the distribution of assets (for example, education) and in the return to these assets. In some countries, such as Mexico, more educated workers saw larger increases in earnings than did others workers, and these gains contributed to increasing income inequality.
- Gender bias and other forms of discrimination have led to increasing inequality where the groups that are discriminated against are poorer than others to start with. For example, discrimination led to lower returns to education and lower overall incomes for ethnic minorities in Vietnam and indigenous groups in Latin America.
- The impact of liberalization programs on inequality has differed among countries. If prereform controls benefit higher-income groups disproportionately, reforms can narrow inequality. If, on the other hand, prereform controls favor the poor, liberalization can have the opposite effect (Ravallion 2000). For example, in the transition to an open trade regime, the poor may suffer if sectors where they have a stake are subjected to competition. This may happen especially in middle-income developing economies with intermediate skill endowments. These economies may have a comparative advantage regarding goods that require medium-intensity skills. These countries are likely to protect sectors intensive in unskilled labor where low-paid workers can be found.<sup>29</sup>

In Africa, slow growth increased both the share and the number of the poor over the 1990s; Africa is now the region with the largest share of people living on less than \$1 per day. In Nigeria, the number of people living in extreme poverty rose steeply following the reversal of the 1985–92 reforms, reaching an es-

timated 70 million (66 percent of the population) based on the national definition (rather than the international \$1-a-day definition used here). Nigeria now accounts for nearly one-fourth of Sub-Saharan Africa's poor. Urban poverty has grown faster than rural poverty, owing to massive migration from rural areas to

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the cities, with the incidence of urban poverty now matching that of rural poverty. By contrast, the rural poverty rate fell in Ethiopia, Sub-Saharan Africa's second most populous country and one of the poorest. The reforms implemented after the end of the civil war in the early 1990s spurred a strong recovery, ending a two-decade slump. The benefits of agricultural price liberalization have spread quickly, boosting growth of rural incomes. Urban poverty, on the other hand, has been stagnant. Urban inequality has risen, in part because of large population movements resulting from the civil war, and in part as a result of economic reform, as agricultural price liberalization raised consumer prices in urban areas and civil service rationalization reduced urban employment. Unfortunately, progress is likely to have been slowed by the border conflict.

In the **Middle East and North Africa**, the percentage of people living on less than \$1 per day declined slightly, but the proportion living below \$2 per day increased, from 25 to 30 percent of the population, because of increases in Egypt, Morocco, and Yemen.

Poverty also rose markedly in the **transition economies** during the 1990s. In the Russian Federation, the breakup of the central planning system was accompanied by a steep fall in output and a sharp increase in inflation. Poverty as measured by the national definition had jumped from an estimated 11 percent during the Soviet period to 43 percent by 1996, and probably increased further with the 1998 crisis. Inequality widened dramatically during the transition, with the Gini coefficient of consumption expenditure rising from an estimated 0.24 in 1988 to about 0.49 in 1998. Increasing disparities in poverty across regions have also surfaced, exacerbated by an inefficient system of fiscal decentralization that left the more backward regions short of resources to assist the poor.

*Prospects for poverty.* As noted above, progress in reducing extreme poverty during the 1990s was constrained by increasing inequality in a few countries that accounted for a large share of the world's poor. As in last

year's *Global Economic Prospects*, this year's poverty scenarios show that continued increases in inequality, coupled with less than robust growth, would imply failure to reach the poverty target for developing countries as a group; in particular, the scenarios indicate substantial increases in the number of poor in Sub-Saharan Africa. Given the uncertainty surrounding the historical estimates for poverty and the risks associated with long-term growth projections, these scenarios should not be viewed as presenting the full range of poverty rates that are likely to occur.

The three poverty scenarios outlined below require a projection of growth of the economy as a whole (and of population growth), a projection of the average growth rate in per capita consumption for the household sector (measured by household surveys)<sup>34</sup>; and a projection of changes in the distribution of per capita consumption.

*Income growth.* The three scenarios differ only in terms of the assumed growth rate for the economy as a whole. Scenario A reflects the base case growth rates, and scenario B reflects the low case growth rates described above. A third scenario assumes that the growth rate of each developing-country region is reduced proportionately from the low-case forecast, so that the average growth for developing countries as a group is equal to that experienced in the 1990s (1.7 percent in per capita terms).

*Consumption trends.* In previous poverty forecasts, the projected growth rate of per capita consumption for households was taken from forecasts of private consumption from the national income accounts. By contrast, the scenarios outlined below take account of recent research that shows that the growth in household consumption from survey data has been lower on average than private consumption growth as measured by the national income accounts. Data for 142 time periods (during the 1980s and 1990s) for 60 countries suggest that the growth of per capita consumption from household surveys was an estimated 87 percent of the growth rate in private consumption from the national accounts.<sup>35</sup>

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The most likely explanation for this discrepancy is that the surveys do not pick up fully the growth in living standards of the rich.<sup>36</sup> As the poverty estimates are based on consumption from household surveys, we assume in poverty forecasts for most developing countries that the growth rate of this variable will equal 87 percent of the growth rate of private consumption from the national income accounts. The failure to adjust the forecast of household consumption growth to reflect the historical divergence from the national income accounts has resulted in substantial overestimation of the rate of poverty reduction in past forecasting exercises.

The discrepancy between consumption growth from the household surveys and the national accounts is larger in China and India (which together account for more than half of the world's poor) and in the Europe and Central Asia region. For China, the time series evidence indicates that 72 percent of a gain in private consumption is reflected in household consumption, and this adjustment is used in the projections. For India, only 28 percent of an increase in private consumption is reflected in the household consumption, and in Europe and Central Asia the time series evidence for the 1990s suggests virtually no correlation between the two consumption aggregates. It is difficult to understand these unusually large discrepancies, which probably reflect serious data problems, as well as the failure to capture the consumption levels of the rich. Thus, the projections for India and the ECA region assume that the share of national accounts growth reflected in the survey mean will equal 51 percent over the forecast period, the lower bound of the 95 percent confidence interval for the estimate for the developing world as a whole (excluding China, India, and Europe and Central Asia).<sup>37</sup>

*Distribution.* The other determinant of the incidence of poverty is in the distribution of household consumption. Long-term cross-country evidence suggests that most countries have not experienced a systematic trend in household consumption inequality as mea-

sured using household survey data. Thus, the assumption for the bulk of the developing countries is that inequality will not change over the forecast period.

However, there are exceptions. The 1990s did witness a dramatic rise in inequality in the Europe and Central Asia region. We assume that this was a transitional phenomenon and will not continue. Further, the available data do indicate a rise in inequality in China and India over the past decade,<sup>38</sup> in part because of slower growth in rural areas, where the majority of the poor live, than in urban areas. We assume that inequality will continue to rise in both countries over the forecast period. In China, the liberalization of trade in agricultural commodities and land markets is likely to allow a shift to more remunerative crops and larger landholdings. Since good quality land is scarce, the consolidation of landholdings and higher returns to good quality land are likely to lead to higher levels of inequality in rural areas. Moreover, continued integration with the world economy will increase the demand for skilled labor. Inequality within urban areas may rise, as wages increase rapidly for skilled workers in manufacturing and some services while low-skill service workers experience lagging wages under the twin pressures of migrant laborers and laid-off workers from the state enterprises. Rising demand for skilled labor may also increase inequality between urban and rural areas, as the gap in educational attainment between the two is high. Thus, both scenarios assume that urban incomes will increase more rapidly than rural incomes, and that inequality within both the rural and the urban sectors will increase slightly, in the form of a 10 percent higher Gini coefficient in each sector by 2015.

In India, rising inequality during the 1990s appears to have slowed the rate of poverty reduction relative to that of the previous decade. So far, reforms have largely bypassed the economy in rural areas, where the majority of the poor live, leading to a wide divergence of growth between urban and rural areas. Weak infrastructure services, limited education, and inadequate health care have made it difficult

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for the poor to share equally in the country's rapid growth. For example, the liberalization process is increasing returns to education, while education is inequitably distributed (one-third of men, and 60 percent of women, over the age of 15 are illiterate). The forecasts assume that the divergence in consumption growth between rural and urban areas will continue along past trends.

*Scenarios.* In scenario A, with base case growth (adjusted for historical differences between household survey and national income accounts consumption) and rising household consumption inequality in China and India, the world as a whole would be on track to reach the International Development Goal of reducing the share of people living on less than \$1 per day by 2015 to half of what it was in 1990. The total number of poor people would decline to about 800 million (see table 1.10 for the forecasts of total population in developing countries). But not all regions would be on track: Africa would be far from reaching the goal even under this favorable growth scenario. With low case growth rates (scenario B), the world as a whole would not reach the target. Only the countries of East Asia would be able to reduce poverty beyond the target of half the 1990 incidence. The total number of poor people in the world (excluding China) would remain unchanged from the 1990 level of about 1 billion.<sup>39</sup> Finally, if aggregate GDP growth in developing countries over the next

**Table 1.10 Population estimates and projections, developing countries, 1998–2015**  
(millions of people)

Region	1998	2015
East Asia and Pacific	1,817	2,099
Excluding China	569	708
Eastern Europe and Central Asia	475	483
Latin America and the Caribbean	502	623
Middle East and North Africa	286	390
South Asia	1,305	1,676
Sub-Saharan Africa	627	914
Total	5,011	6,185
Excluding China	3,763	4,794

Source: World Bank staff estimates.

15 years were to equal the average of the 1990s, then progress in poverty reduction would be even slower than in scenario B, and the number of people living on less than \$1 a day at the end of the forecast period would be only marginally lower than in 1998. The number of poor based on the \$2 per day level would actually increase. Table 1.11 provides a summary of the poverty forecasts, and tables 1.12 and 1.13 give regional details for the two scenarios that use the base case and low case growth rates.

The preceding scenarios highlight the importance of achieving fast growth and distributing the benefits of growth equitably. Without

**Table 1.11 Poverty in developing countries under scenarios of base case growth (scenario A); low case growth (scenario B); and 1990s average growth, 1990, 1998, 2015**

	\$1 a day		\$2 a day	
	Headcount ratio (percent)	Number of poor (million)	Headcount ratio (percent)	Number of poor (millions)
1990	29.0	1,276	61.7	2,718
1998	23.4	1,175	56.1	2,812
2015: scenario A (base case growth)	12.6	777	36.7	2,272
2015: scenario B (low case growth)	16.4	1,011	43.2	2,672
2015: growth as in 1990s	18.7	1,157	47.5	2,938

Source: World Bank staff estimates.

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**Table 1.12 Regional breakdown of number of people living on less than \$1 per day and head count index in developing countries, under scenarios of base case growth (scenario A) and low case growth (scenario B), 1990, 1998, and 2015**

Region	Number of people living on less than \$1 per day			
	1990	1998	2015 low case	2015 base case
East Asia and Pacific	452.4	267.1	100.7	65.1
Excluding China	92.0	53.7	20.1	9.4
Europe and Central Asia	7.1	17.6	9.0	6.3
Latin America and the Caribbean	73.8	60.7	58.3	42.8
Middle East and North Africa	5.7	6.0	6.2	5.1
South Asia	495.1	521.8	410.7	296.7
Sub-Saharan Africa	242.3	301.6	426.2	360.6
Total	1,276.4	1,174.9	1,011.2	776.5
Excluding China	915.9	961.4	930.6	720.9
Region	Headcount index (percent)			
	1990	1998	2015 low case	2015 base case
East Asia and Pacific	27.6	14.7	4.8	3.1
Excluding China	18.5	9.4	2.8	1.3
Europe and Central Asia	1.6	3.7	1.9	1.3
Latin America and the Caribbean	16.8	12.1	9.4	6.9
Middle East and North Africa	2.4	2.1	1.6	1.3
South Asia	44.0	40.0	24.5	17.7
Sub-Saharan Africa	47.7	48.1	46.7	39.5
Total	29.0	23.4	16.4	12.6
Excluding China	28.1	25.6	19.4	15.0

Source: World Bank staff estimates.

macroeconomic stability, sustained structural reforms, prudent and transparent use of public resources, improvements in the provision of public services and infrastructure to the poor, and actions to reduce vulnerability and give the poor more voice in development choices, the pattern of sustained, inclusive growth that underlies the best scenario will not be realized and millions more people will remain enslaved in poverty. Achieving the poverty reduction targets also will require an increase in aid flows to the poorest countries. With slow growth and increases in inequality, progress would be much slower everywhere, the target would be out of reach for all regions apart from East Asia, and more than 200 million more people worldwide would remain mired in poverty. If policies are inadequate to achieve more than the slow growth of the 1990s, then the number

of people living in extreme poverty would remain near current levels for the next 15 years.

In Africa, the number of people living in poverty would increase under all scenarios. If the lack of progress observed over the last decade with respect to other dimensions of poverty—life expectancy, school enrollment, and child mortality—continues, as may well be the case if the AIDS epidemic is not stemmed, then the gap between the region and the rest of the world could widen significantly. This would be a grim outlook, not just for Africa but for the whole world, and efforts are needed in the region and elsewhere to break with the recent pattern of conflict and crisis, and to deal with the AIDS epidemic.

Even if the most optimistic scenario is achieved, 2.3 billion people would still be living on less than \$2 per day in 2015. Thus, the

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**Table 1.13 Regional breakdown of number of people living on less than \$2 per day and head count index in developing countries, under scenarios of base case growth (scenario A) and low case growth (scenario B), 1990, 1998, and 2015**

Region	Number of people living on less than \$1 per day			
	1990	1998	2015 low case	2015 base case
East Asia and Pacific	1,084.4	884.9	472.2	323.2
Excluding China	284.9	252.1	187.2	114.6
Europe and Central Asia	43.8	98.2	57.6	46.9
Latin America and the Caribbean	167.2	159.0	161.6	132.9
Middle East and North Africa	58.7	85.4	79.7	57.5
South Asia	976.0	1,094.6	1,213.6	1,077.8
Sub-Saharan Africa	388.2	489.3	690.3	636.7
Total	2,718.4	2,811.5	2,675.0	2,275.1
Excluding China	1,918.8	2,178.7	2,390.0	2,066.5
Region	Headcount index (percent)			
	1990	1998	2015 low case	2015 base case
East Asia and Pacific	66.1	48.7	22.5	15.4
Excluding China	57.3	44.3	26.4	16.2
Europe and Central Asia	9.6	20.7	11.9	9.7
Latin America and the Caribbean	38.1	31.7	25.9	21.3
Middle East and North Africa	24.8	29.9	20.4	14.7
South Asia	86.8	83.9	72.4	64.3
Sub-Saharan Africa	76.4	78.0	75.6	69.7
Total	61.7	56.1	43.3	36.8
Excluding China	58.8	57.9	49.9	43.1

Source: World Bank staff estimates.

global war on poverty is likely to be with us well into the twenty-first century.

In closing, it is important to note that these projections have some serious limitations. First, despite enormous progress in measuring poverty over the past 10 years, the database has significant weaknesses: recent data are missing for a number of countries, especially in Africa, where renewed efforts are needed to institutionalize survey work that began in the 1990s. Major questions remain as to the trends for India. In addition, our understanding of trends in inequality and the divergence between national accounts and household-based measures of private consumption is limited. Research to address some of these limitations, including further analysis of the data for India, is underway.

## Notes

1. See Gale and Sabelhaus 1999.
2. Gross capital inflows (largely portfolio flows) exceeded \$750 billion in 1999. See U.S. Department of Commerce, *Survey of Current Business*, various issues.
3. In the four quarters through the second quarter of 2000, year-on-year growth in nonfarm business output per hour has averaged 4 percent.
4. Indeed, Gordon (forthcoming) evaluates recent labor productivity growth in the United States, applying cyclical factors, and he argues that the failure itself—of IT productivity gains to penetrate into non-IT sectors—implies that the growth momentum in trend productivity will not be sustained.
5. For a number of service industries (for example, education), the current method for measuring productivity involves assuming that real output and price changes move together—that is to say that there is no labor productivity growth (Bosworth and Triplett 2000).

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6. This figure is strongly influenced by large carry-over in GDP levels from late 1999 and first-half 2000; growth on an annualized basis is anticipated to fall within a range of 3 percent during the second half of the year.

7. This assumes little or no increase in participation rates from the average of the 1990s.

8. The total population of the EU, assuming all countries now under consideration (excluding Turkey) join, will be close to 500 million in 2010, with the new members representing close to 25 percent of the total.

9. There is an entire literature on strategic linkages between multilateral and regional integration agreements. See World Bank 1999, Section 5, for more detailed discussion.

10. For more discussion, see Hoekman and Kostecki 1995.

11. Nonetheless, many developing-country members of the WTO—particularly the least developed—still face significant impediments in being able to participate fully in the workings of the WTO and other international bodies related to international trade (see chapter 3). Capacity building, technical assistance, and financial resources to help developing countries improve their presence in Geneva are major items on their agenda for the new post-Uruguay Round negotiations.

12. Some authors have argued that North-South conclaves are an important impetus for democratization, and very recent experience with EU enlargement and the NAFTA do not contradict this view.

13. Forty-two of the 108 notifications listed in figure 1.13 represent extensions of the EU or NAFTA.

14. Since intraregional trade is usually among closer substitutes than extraregional trade, the former can be more vulnerable to the business cycle.

15. The performance of stock markets in developing countries was heavily influenced by the technology and telecommunications sectors, which accounted for some 65 percent of total equity placements in the first half of 2000.

16. The 1999 figure of \$180 billion reflects a revision from the estimate of \$192 billion presented in *Global Development Finance 2000* because of lower levels of inflows to China and Saudi Arabia during the year.

17. However, the recent downtrend in FDI to China may be reversed, as the value of approved projects rose 25 percent year on year during the first five months of 2000.

18. Global crossborder acquisitions of a more than 10 percent-stake reached \$720 billion in 1999, up 35 percent from 1998.

19. Oil prices deflated by the U.S. Dollar Manufactured Export Unit Value (MUV) index for France, Germany, Japan, the United Kingdom, and the United

States. The latter index has been essentially flat over the 1990s.

20. See appendix 1, Regional Economic Prospects, for further details.

21. The percentage of the population on wages “below subsistence” remains high at 27.6 percent, according to official estimates as of June 2000. However, it has declined significantly from the 34 percent average of 1999.

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

23. Figures for 1998 were updated in September 2000 using data from surveys that have become available only recently, and they differ slightly from the preliminary estimates included in last year’s *Global Economic Prospects*.

24. The estimates of global poverty given here are based on consumption, and income data are adjusted accordingly.

25. A common way to measure inequality is to calculate the Gini coefficient. The Gini coefficient would be equal to 0 if all had the same income and to 1 if one person had all the income and everybody else had none. We observe Gini coefficients for income in the range of 0.2 to 0.6 (the Slovak Republic has the lowest Gini, 0.195, while Swaziland and Brazil have the highest (0.6); among OECD countries, Austria has the lowest Gini at 0.23 and New Zealand the highest at 0.44 (World Bank 2000c).

26. Inequality is estimated with a certain degree of uncertainty, as it is based on sample surveys. Thus changes over time need to be considered carefully to assess whether they are significant to a certain degree or whether they fall within the margin of error. The estimation of standard errors is complex, and work on this is just beginning.

27. See for example Deininger and Squire 1996; Ravallion and Chen 1997; Bruno, Ravallion, and Squire 1998; Dollar and Kraay 2000.

28. For example, in the Indian state of Uttar Pradesh—which has a population of 160 million and a poverty rate of about 40 percent—agriculture accounts for 40 percent of GDP and provides 75 percent of employment.

29. For example, in Mexico, a country that implemented one of the most ambitious trade policy reform programs from 1985 to 1988, the nominal tariff and import license coverage in apparel and footwear were among the highest in manufacturing (Revenga 1995). A similar prereform pattern of protection was also found in Morocco (Currie and Harrison 1997).

30. The data for China pose several problems. First, consumption per capita, as estimated by surveys, has been growing less rapidly than estimates of private consumption from the national accounts would sug-

gest. Second, urban household surveys do not include rural migrants. Third, savings rates are very high in China, even among the poor, so poverty estimates based on consumption measures yield a higher poverty incidence than those based on income. Moreover, it appears that savings rates increased among the poor over this period. The estimates above differ from official estimates, and new survey work will be needed to reconcile the differences (work on urban surveys is under way). These discrepancies cast doubt on the estimates for China and therefore on the global estimates, given the size of the country.

31. Unfavorable trends in agriculture partly reflect inefficiencies in public support to farming, as well as limited reform, in contrast to the deregulation of the urban sector.

32. The major differences are that consumption measures from household surveys sometimes do not include imputed housing, and private consumption in the national accounts typically includes spending by non-profit enterprises (nongovernmental organizations, political parties, churches, charities, and so on) as well as households.

33. For example, a household with at least 2.5 acres enjoyed 43 percent higher per capita consumption in 1995–96 than did a landless rural household (World Bank 1999).

34. This excludes consumption by other private entities such as nonprofit organizations, political parties, unincorporated enterprises and so forth that are often included in the national accounts estimate of private consumption.

35. See Ravallion 2000. India, China, and Europe and Central Asia are excluded from this estimation.

36. There is a presumption that higher-income groups tend to underreport consumption. Moreover, consumption measures from household surveys sometimes do not include imputed housing expenditures, which, in fast-growing economies, are likely to grow rapidly in the higher-income groups. There are other explanations for the divergence between survey mean household consumption growth rates and those from the national accounts, including the fact that (for most countries) private consumption in the national accounts includes spending by nonprofit enterprises (such as churches and charities and so on) as well as households, and the share of the nonprofit sector is probably rising.

37. This assumption has an important impact on the forecasts. For example, if in India consumption were assumed to rise at 87 percent (rather than 51 percent) of the national income accounts growth rate, then by 2015 the forecast (using base case growth rates) for extreme poverty in South Asia would be only about half the 22 percent rate shown for scenario A.

38. For example, the per capita consumption (as measured in the household survey) of the bottom 10 percent of China's population increased by 2.5 percent per year during 1990–98, while per capita consumption of the top 10 percent increased by 11 percent per year. In India, per capita consumption of the bottom 10 percent did not increase at all during 1985–97, while the top 10 percent saw a rise of 4.7 percent per year.

39. These results are roughly similar to the poverty forecasts in *Global Economic Prospects 2000*. In scenario A, the head count poverty index is 15.9 percent in 2008 (the last year of the *GEP 2000* forecasts), compared with 12.3 percent in *GEP 2000*. This year's forecast is more pessimistic because we assume that growth in household consumption will be slower than in private consumption in the national income accounts. Conversely, the *GEP 2000* forecast for scenario B was more pessimistic (head count index of 21.9 percent compared with 19.5 percent now), because last year we assumed a rise in inequality in all regions.

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**Table A1 Membership of selected major regional integration agreements (RIAs) and date of formation**

## INDUSTRIAL AND DEVELOPING ECONOMIES

**European Union (EU):** formerly European Economic Community (EEC) and European Community (EC), 1957: Belgium, France, Germany, Italy, Luxembourg, Netherlands; 1973: Denmark, Ireland, United Kingdom; 1981: Greece; 1986: Portugal, Spain; 1995: Austria, Finland, Sweden.

**European Economic Area (EEA):** 1994: EU, Iceland, Liechtenstein, Norway.

**Euro-Mediterranean Economic Area (Euro-Maghreb):** Bilateral agreements, 1995: EU and Tunisia; 1996: EU and Morocco.

**EU bilateral agreements with Eastern Europe:** 1994: EC and Hungary, Poland, 1995: EC and Bulgaria, Romania, Estonia, Latvia, Lithuania, Czech Republic, Slovak Republic, Slovenia.

**Canada-US Free Trade Area (CUSFTA):** 1988: Canada, United States.

**North American Free Trade Area (NAFTA):** 1994: Canada, Mexico, United States.

**Asia Pacific Economic Cooperation (APEC):** 1989: Australia, Brunei Darussalam, Canada, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, United States; 1991: China, Taiwan (China), Hong Kong (China); 1993: Mexico, Papua New Guinea; 1994: Chile; 1998: Peru, the Russian Federation, Vietnam.

## LATIN AMERICA AND THE CARIBBEAN

**Andean Pact:** 1969: revived in 1991, Bolivia, Colombia, Ecuador, Peru, Republica Bolivariana de Venezuela.

**Central American Common Market (CACM):** 1960: revived in 1993, El Salvador, Guatemala, Honduras, Nicaragua; 1962: Costa Rica.

**Southern Cone Common Market, Mercado Común del Sur (Mercosur):** 1991: Argentina, Brazil, Paraguay, Uruguay.

**Group of Three (G-3):** 1995: Colombia, Mexico, Republica Bolivariana de Venezuela.

**Latin American Integration Association (LAIA):** formerly Latin American Free Trade Area (LAFTA), 1960: revived 1980, Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela.

**Caribbean Community and Common Market (CARICOM):** 1973: Antigua and Barbuda, Barbados, Jamaica, St. Kitts and Nevis, Trinidad and Tobago; 1974: Belize, Dominica, Grenada, Montserrat, St. Lucia, St. Vincent and the Grenadines; 1983: The Bahamas (part of the Caribbean Community but not of the Common Market).

## MIDDLE EAST AND ASIA

**Association of Southeast Asian Nations (ASEAN):** 1967: ASEAN Free Trade Area or AFTA was created in 1992, Indonesia, Malaysia, Philippines, Singapore, Thailand; 1984: Brunei Darussalam; 1995: Vietnam; 1997: Myanmar, Lao People's Democratic Republic; 1999: Cambodia.

**Gulf Cooperation Council (GCC):** 1981: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

**South Asian Association for Regional Cooperation (SAARC):** 1985: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka.

## AFRICA

**Cross-Border Initiative (CBI):** 1992: Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.

**East African Cooperation (EAC):** 1967: formerly East African Community (EAC), broke up in 1977 and recently revived, Kenya, Tanzania, Uganda.

**Economic and Monetary Community of Central Africa (CEMAC):** 1994: formerly Union Douanière et Economique de l'Afrique Centrale (UDEAC), 1966: Cameroon, Central African Republic, Chad, Congo, Gabon; 1989: Equatorial Guinea.

**Economic Community of West African States (ECOWAS):** 1975: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo.

**Common Market for Eastern and Southern Africa (COMESA):** 1993: Angola, Burundi, Comoros, Djibouti, Egypt, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.

**Indian Ocean Commission (IOC):** 1984: Comoros, Madagascar, Mauritius, Seychelles.

**Southern African Development Community (SADC):** 1980: formerly known as the Southern African Development Coordination Conference (SADCC), Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia, Zimbabwe; 1990: Namibia; 1994: South Africa; 1995: Mauritius; 1998: Democratic Republic of the Congo, Seychelles.

**Economic Community of West Africa (CEAO):** 1973: revived in 1994 as UEMOA, Benin, Burkina Faso, Côte d'Ivoire, Mali, Mauritania, Niger, Senegal.

**West African Economic and Monetary Union (UEMOA or WAEMU):** 1994: Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo, 1997: Guinea-Bissau.

**Southern African Customs Union (SACU):** 1910: Botswana, Lesotho, Namibia, South Africa, Swaziland.

**Economic Community of the Countries of the Great Lakes (CEPGL):** 1976: Burundi, Rwanda, Democratic Republic of the Congo.

Source: World Bank 1999.