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World Bank Links Prospects for Development To Economic Growth in Industrial Nations

The economic performance of the industrial countries over the next ten years will have a major influence on whether economic prospects for developing countries will improve, or whether the world economy will be balanced "on a knife's edge," with millions of people in developing countries becoming progressively poorer, according to the *World Development Report 1984*, released by the World Bank on July 11. The report makes it clear, however, that developing countries can partly offset the effects of slow growth in the industrial world by improving their own policies. The report, the seventh in an annual series that assesses development issues, is in two parts. Part I examines past and prospective economic performance in both industrial and developing countries, while Part II focuses on population—the causes and consequences of rapid population growth, its link to development, and why it has slowed down in some developing countries.

The first part of the report presents two basic scenarios for economic growth. The "high-case" scenario projects a growth rate of gross domestic product (GDP) of 4.3 percent a year in the industrial countries in 1985–89. Under this scenario, unemployment in developed countries falls steadily, inflation averages 4.3 percent annually (3.5 percent in dollars at present exchange rates), budget deficits are reduced, and nominal interest rates fall to 6 percent. Developing countries' GDP grows at about 5.5 percent yearly in the high scenario, and world trade grows at about 7 percent annually in real terms. The debt-servicing capability of developing countries improves, and they are able to obtain substantial additional credit.

The "low-case" scenario presented in the report assumes a GDP growth of only 2.5 percent a year in industrial countries, with inflation averaging 6 percent annually. Unemployment and budget deficits in these countries remain high under this scenario, and nominal interest rates average 9.5 percent. This scenario calls for GDP growth of only 4.7 percent annually for developing countries as a group, implying little or no growth for some of these countries.

Industrial Country Policies. According to the report, the performance of the industrial countries will make the difference between progressing along the lines of the low-case or the high-case scenarios. In particular, the report suggests, the "main focus of industrial countries in the years ahead should be on developing ways to reduce budget deficits." Although economic recovery is likely to stimulate higher saving in industrial countries, global savings rates are not expected to regain their level of the early 1970s, at least not in the immediate future. As recovery in the industrial countries leads to increased demand for money and greater investment, both short-term and long-term real rates of interest can be expected to remain relatively high. At the same time, the financing of public spending may become more difficult in many developed countries, as the political will to increase taxation proves weaker than the pressures for more spending. In order to contain inflation, most industrial countries will need to maintain tight monetary policies, and, given the fiscal pressures, the real cost of borrowing is likely to remain high. Budget deficits will tend to grow as the real interest burden is compounded.

Industrial countries also must avoid implementing protectionist policies. In order to demonstrate the adverse effects on developing countries of protectionism, the low-case scenario contains a variant that assumes that governments in industrial countries step up protection against imports from developing countries. In this variation of the low-case scenario, the average annual growth of GDP for all developing countries from 1985–95 drops to 4.3 percent from the 4.7 percent projected in the base low scenario. GDP growth for developing countries that are major exporters of manufactures declines to 4.4 percent, compared with 5.2 percent under the unaltered low scenario.

Developing Country Policies. A second variant of the low-case scenario assumes that slow growth in the industrial world is accompanied by improved policies in

Average Performance of Industrial and Developing Economies
(average annual percentage change)

Country Group	1960–73	1973–79	1980–85	1985–95 High case	1985–95 Low case
Industrial economies					
GDP growth	4.9	2.8	1.9	4.3	2.5 ✓
Inflation rate[1]	6.1	9.9	2.3	4.3	6.8
Real interest rate[2,3]	2.5	0.7	5.2	2.5	3.5
Nominal lending rate[4]	5.8	8.4	11.6	6.0	9.5
Developing economies[5]					
GDP growth	6.3	5.2	2.8	5.5	4.7
Low-income					
Asia	5.9	5.2	5.8	5.3	4.6
Africa	3.5	2.1	1.7	3.2	2.8
Middle-income oil importers					
Major exporters of manufactures	6.7	5.8	1.6	6.3	5.2
Other	5.3	4.3	1.9	4.3	3.8
Middle-income oil exporters	*6.9*	*4.9*	*2.4*	*5.4*	*4.7*
Export growth[5]	**6.3**	**3.1**	**5.5**	**6.4**	**4.7**
Manufactures[5]	14.9	10.6	8.1	9.7	7.5
Primary[5]	5.0	0.9	4.0	3.4	2.1
Import growth[5]	**6.4**	**5.9**	**3.2**	**7.2**	**5.1**

Note: Projected growth rates are based on a sample of 90 developing countries.
[1] Inflation in the United States is 3.5 percent a year in the high case and 6 percent in the low case. But for the industrial countries as a whole, it is higher in dollars because of an assumed depreciation of the dollar of 13 percent between 1985 and 1990.
[2] Average of three-month U.S. dollar Eurocurrency rates for the periods 1960–73 and 1973–79, deflated by the rate of change in the U.S. GDP deflator.
[3] Average annual rate.
[4] Does not include South Africa.
[5] Historical growth rates are for the periods 1965–73 and 1973–80.

Data: World Bank, *World Development Report 1984*

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the developing countries. Under this scenario, developing countries achieve faster GDP growth by raising savings and investment rates, by increasing and diversifying their exports, and by using imports more efficiently. According to the report, these policies "would allow GDP to grow in developing countries at an average rate of 5.1 percent a year, recovering half of the difference between the Low and High cases." Thus, the report emphasizes, developing countries can partly offset the effects of slow growth in the industrial world by improving their own policies.

The report also discusses the critical importance of world economic growth and an open trading system for resolution of the debt problem. In the low scenario, during 1985–95, average annual interest rates are higher (9.5 versus 6.0) and the average annual percentage growth of developing country exports (4.7 versus 6.4) and GDP (2.5 versus 4.3 for industrial economies, 4.7 versus 5.5 for developing countries) lower than in the high scenario. In the low case, export revenues grow only slightly more rapidly than the interest rate, and net lending falls. According to the report, a long-term prospect of capital inflows that are insufficient to cover interest payments, combined with slow export growth, implies that debt service is economically, and therefore politically, costly.

The large current account deficits of many developing countries in the early 1980s have necessitated substantial adjustments to permit these countries to cover interest obligations, the report points out. It suggests that, although the "best way to have adjusted would have been to combine cuts in spending with policies to switch production into exports and into efficient import substitution," instead imports were cut dramatically (through use of direct restrictions on imports), with adverse implications for growth.

The report also recommends a change in financial market attitudes as a necessary component of adjustment. It describes the conflict between commercial lenders, who respond to risk by pushing for more rapid repayment by debtors, and debtor countries, who, in trying to minimize current consumption losses, try to postpone adjustment as long as possible. The report points out that the "achievement of an adjustment 'package' implies the recognition by both parties of an intermediate solution that does not jeopardize either the probability of repayment or the consumption of future generations." The report also suggests that "the longer-term prospects for the world economy will help determine whether the present ad hoc combination of rescheduling by creditors and austerity by debtors proves to be the prelude to a harmonious resolution or the prologue to a disaster."

Population Growth. The second part of the *World Development Report* focuses on population growth, in particular its impact on poverty. It points out that, whereas modest growth in the GDP of industrial countries means modest growth in their per capita incomes, for the developing countries there is no such easy equation. The populations of developing countries are growing by 2 percent a year (by more in some countries), so that GDP growth of 2 percent is merely a preliminary step before they can start to improve their per capita incomes. "Failure to act now to slow [population] growth," the report asserts, "is likely to mean a lower quality of life for millions of people."

The report points out that the rate of population growth from 1750 until well into the twentieth century was 0.5 percent a year. From the beginning of the century until 1950 the rate accelerated to 1 percent a year, and since 1950 the rate has again accelerated to an unprecedented 2 percent a year. In addition, population growth since 1950 has been concentrated largely in the developing countries. Since 1950 the population growth rate has never exceeded 1 percent in Europe and has seldom exceeded 1.5 percent in North America. Driven by falling mortality and continued high fertility, however, the population growth rate of developing countries rose above 2 percent a year in the postwar years and reached a peak of 2.4 percent in the 1960s. The growth rate is now about 2 percent a year.

According to the report, "further decline in population growth will not come automatically." On the contrary, the report suggests, such a slowdown will require a continuation and strengthening of policies geared to reducing fertility. Current population projections, which assume fertility will continue to fall, indicate that world population will rise to almost 10 billion by 2050 and will not stabilize until the middle of the twenty-second century, in the range of 11–12 billion. In this context, the second part of the report focuses on three themes: (1) that rapid population growth is a development problem; (2) that there are appropriate public policies to reduce fertility; and (3) that experience shows that policy makes a difference.

A Development Problem. The report makes the case that rapid population growth is a development problem, for several reasons. First, "it exacerbates the awkward choice between higher consumption now and the investment needed to bring higher consumption in the future." In developing countries where scarce human skills and limited technology make investment particularly critical for economic growth, faster population growth puts even greater strains on limited available investment resources. Second, in many countries, where most people depend on agriculture for a living, population increases threaten the precarious balance between natural resources and people. Third, rapid population growth complicates the already difficult management of economic and social change. The report points out that "agricultural modernization and diversification into manufacturing will require large new investments in both human and physical capital, and considerable administrative and political skill to ensure efficient allocation of scarce investment resources."

Public Policies. The report suggests that a slower rate of population growth is both desirable and possible, while acknowledging that proposals for reducing population growth raise difficult questions about the proper domain of public policy. According to the report, in the transition from a traditional to a modern economy, the private gain from having many children may exceed the social gain. The report illustrates this point by describing the "isolation paradox," as follows:

In a small village, a father of three children dreams of having more children. He believes that more children would enable him to harvest more land. He could then divide this additional land among his sons, and they could work to support him in his old age. This plan is shared by all fathers in the village, however, and the amount of land in the village is limited. As a result, most children will have less land than their fathers. In this case, the sum of the individual decisions taken for private benefit ends up making most people worse off.

This phenomenon is known as the isolation paradox. Individuals in isolation act to the detriment of each other unless they know that their fellows will act in a manner that serves the general well-being —and even then individuals may not act in the public interest themselves.

This gap between private and social gains requires public policy to provide alternative ways of securing the benefits that many children provide for their parents. These policies work by changing the signals that otherwise encourage high fertility:

- Improved education and health opportunities help assure parents that a few children will survive to become healthy adults with good work opportunities.
- Educational and employment opportunities can be opened to women for whom childbearing is at present the only real source of status and security.
- Information can be made available about family planning, falling mortality rates, and the health risks of having large families.

Policies Make a Difference. The report points out that in the past two decades the experience of many countries shows that effective measures can slow population growth. Many countries have already succeeded in reducing birth rates—by 20 percent to 50 percent since 1965 in Sri Lanka, Tunisia, Mexico, India, Korea, Thailand, and Colombia, for example. In China, a public policy to reduce population growth includes public education, social pressure, and economic measures. According to the report, the "pattern of decline shows that differences in income, religion, and culture do not tell the whole story. Education, access to family planning services, the status of women, and economic and social policies that bring opportunities to the majority of people all make a difference."

Family Planning. According to the report, approximately 85 countries in the developing world, representing more than 90 percent of its population, now provide publicly subsidized family planning programs. Despite the success that many of these programs have had in improving couples' access to information and services, the report asserts that more could be done in all countries. For example, nearly all programs still fail to reach most rural people. In addition, 27 countries have not yet introduced family planning programs; almost half of these are in Africa, where incomes are the lowest, population growth the highest, and the potential benefits from family planning possibly the greatest.

To illustrate what is possible, the report provides examples of the implications for population growth of "rapid" mortality and fertility declines. For most countries, these declines would mean fertility rates of between two and three children per couple in the year 2000 and population growth rates of between 1 percent and 2 percent. The report suggests that some countries may wish to move to even lower or zero population growth. The report stresses, however, that the important lesson to be learned is that "the course of future population growth and its effects on social and economic progress are well within the realm of conscious human choice."

To Order Development Report

Copies of the *World Development Report 1984* are available from World Bank Publications, P.O. Box 37525, Washington, D.C. 20013 or 66, Avenue d'Iéna, 75116 Paris, France, at a price of $20.00 a copy (cloth) or $8.00 (paper). Copies of the report in English are also available from the Oxford University Press. The report is also being published in Arabic, Chinese, French, German, Japanese, Portuguese, and Spanish, with publication dates and prices varying.