The external pressures on developing countries have shown little sign of easing over the past 12 months. The combined current account deficit of the oil-importing countries rose from $26 billion in 1978 to $70 billion in 1980 and may rise even higher this year. Slow growth in the industrial countries is curbing demand for developing countries' exports while the price of petroleum (a product that now constitutes some 25 percent of developing countries' import bills) increased over 80 percent in real terms between 1978 and 1980.

While many of the better-off developing countries have been able to expand exports and borrow extensively in commercial markets, for most of the poorer countries these new pressures come at the end of a decade in which they have made little or no progress. Some countries in South Asia have weathered the 1970s reasonably well. But the majority of the poor countries of Asia and Africa suffered reduced growth in the 1970s, participated negligibly in the expansion of world trade and benefited from aid increases only for a short period after the first oil-price rise.

Now they face the 1980s, which have started badly for them, with no sign of change in either their trade or their aid prospects. There is much to be improved in their domestic performance. But without more support from the international environment, their maximum efforts can at best yield only slow progress. The world will divide even more sharply between the haves and the have-nots. These countries, even excluding China, have a population of well over 1 billion people. The 1980s therefore pose the question of how developing countries in general can maintain or accelerate their growth; and how the poor countries in particular can find ways out of an increasingly desperate predicament.

This fourth World Development Report offers an integrated discussion of international and national economic policy issues. It deals with the main dimensions of adjustment in the global economy, their counterparts in national economies, and the interactions between the two. The Report will thus:

- consider the prospects of the developing countries in the 1980s;
- analyze recent experience in world trade, energy markets and international capital flows; and
- examine the diverse nature of country adjustment to the transformed international environment.

Transformation is not too strong a word to describe the contrast between the 1960s and 1970s. Slow growth and fast inflation in the industrial countries, major increases in oil prices, the breakdown of the fixed-exchange-rate system, the changing pace and character of international trade (with its acute contrast between the rapid export growth of manufactures and the much slower growth of exports of primary commodities), the steep rise in the flow of commercial bank loans to developing countries: few of these were foreseen a dozen years ago—a fact which counsels caution in looking at prospects in the 1980s. At the same time, those who quite properly expect the 1980s to be a period of trial for many developing countries may reflect that the 1970s witnessed international economic convulsions at least as serious as any that may be thought highly probable in the next 10 years. The world economy's capacity to withstand shocks has been severely tested. The tests were not passed with entire success; growth slowed down and weaknesses in the trading and financial environment have been exposed; but parts of the developing world have come through remarkably well.

To analyze the experience of the 1970s, this Report makes use of the extensive work carried out in the World Bank and elsewhere on the recent progress of development. The links between domestic and international policies and performance emerge clearly. Developing countries have to adjust to new circumstances; their effectiveness in doing so depends critically on
their domestic management as well as on the industrial and oil-exporting countries' domestic and international policies.

A second conclusion of the Report's analysis is the need for durable changes in economic policy. Over the past two years, many developing countries have paid for part of their increased import bills by a combination of short-term borrowing and drawing on reserves. By definition, these are temporary expedients. Certainly, developing countries will need to borrow more in the future, from both private and official sources. But many will have to take new steps—or intensify existing efforts—to increase exports or reduce imports so as to achieve smaller, sustainable deficits. For many of them, a principal result of the changed external environment is to make long-needed improvements in domestic economic management all the more urgent.

These domestic factors must complement the national and international measures required for an orderly transition to lower deficits. Structural changes are needed to help minimize the sacrifice of near-term growth and long-term development. In the absence of satisfactory national action and a supportive international environment, there will be a deflationary transition, involving severe and avoidable losses in output, and unnecessary human suffering and harm to development prospects.

Global adjustment

In international terms, perhaps the biggest change from the 1960s and early 1970s is the new importance of trade and financial flows in balancing out payments for oil. In this context, adjustment means ensuring that this balance, along with changes in the use of energy, occurs in such a way as to permit world growth to return to something approaching its earlier pace. It may be impossible to match the growth rates of the 1960s, but it is surely possible to surpass the record of the past seven years.

The suddenness of the oil-price increases and their consequences for the pattern of global deficits and surpluses has required an equally fast realignment of trade and international borrowing. Much of this has taken place. Expanded exports have helped industrial and middle-income countries to pay for their oil imports. The low-income oil-importing countries have been less successful, although several of them have enjoyed various offsetting benefits (like migrant workers' remittances) from the rise in oil prices. Another part of adjustment is containing energy demand; this was slow to start, but has recently begun to make headway, especially in the industrial countries. A further component of adjustment, which takes even longer, will be changes in energy supplies: the transition to more plentiful fuels—especially coal—and eventually to renewable sources.

In aggregate terms, higher oil prices can be viewed as ultimately requiring an offsetting transfer of goods from oil-importing to oil-exporting countries. An equivalent effect would follow from any major terms-of-trade change, for example, between manufactures and primary commodities; but the scale and speed of the rise in oil prices give them particular significance. To the extent that oil exporters spend their new revenues, the transfer takes the form of the extra imports they buy; to the extent that they lend them to oil importers, the transfer is postponed—the lender acquires a financial asset and the borrower pays interest. It is possible to envisage numerous different patterns of current account surpluses and deficits resulting from higher oil prices. On their own, however, they reveal little about the success of adjustment since that also depends on what happens to world economic growth.

The surpluses of one group of countries are by definition reflected in the deficits of others. But while the trade and financial flows which underlie them are synchronized as a whole, for individual countries export earnings and borrowing may not match their desired levels of imports. Oil exporters import mainly from the industrial countries, rather than from developing countries, which would help them pay for their oil. And no mechanism ensures that capital flows are distributed among deficit countries according to their balance-of-payments financing requirements.

In both trade and capital flows there is an asymmetry between the industrial and the developing countries. Not only do the industrial countries pay for a large share of additional oil bills by exporting to the oil producers; their balance of payments is much less affected by oil prices, and their adjustment and growth are mainly determined by their own policies. The oil exporters invest there, and they have easier access to capital in general. The developing countries' adjustment is more constrained: they depend heavily on the growth and openness of industrial-country markets for their exports and on the aid and credit institutions of the industrial countries for their external financial needs. The main force of world growth still flows from the developed to the developing world, even if today the new trade and financial links make the trans-
mission of economic activity in
the reverse direction ever more
important.
This Report’s examination of
trade, energy and capital flows
draws attention to some par-
ticularly important conditions for
the satisfactory functioning of
global adjustment. They include
the success of the industrial coun-
tries in mastering inflation and
other constraints on growth, their
avoidance of protectionism and
their support for expansion of
financial flows to developing
countries from the private mar-
kets. The oil-importing developing
countries need to expand exports
and make efficient use of bor-
rowed capital to increase produc-
tive capacity, so that loans can be
serviced. In all the oil-exporting
countries, patterns of domestic
development are intertwined with
policies on oil production and oil
prices, which affect their import
demand and also weigh heavily in
the global balance. And the in-
ternational financial institutions
have a key role to play in becom-
ing more prominent in facilitating
international flows of commercial
capital.
Many of these adjustments
need time. While payment for
higher oil import bills through
trade and finance takes place
rapidly, borrowing has its limits,
and the resumption of sustainable
growth above recent levels re-
quires more fundamental changes
—control of inflation, raising pro-
ductivity, new investment to
reflect rising energy costs. For
low-income countries especially,
reshaping domestic production to
raise exports, economize on
imports and take account of new
energy scarcities must be a leng-
thy process. If they are not to be
forced to adjust by curbing growth
rates—which for most of them are
already low—and abandoning
other development objectives,
they must receive reliable support
from the international commu-
nity. For the world economy as a
whole, a period of transition is
inevitable until the pattern of cur-
rent account balances and foreign
indebtedness can be managed
more smoothly and with less fre-
cquent need for intervention by
governments and international
agencies.

Projections
The next chapter of this Report
reviews the global prospects for
the 1980s, bracketing in two sce-
narios what is considered a plausi-
ble range of developments. Be-
cause the decade has started with
very slow growth in the industrial
countries, the outlook is some-
what worse than was projected in
last year’s Report. Even under the
higher scenario, average per cap-
ita incomes are expected to grow
by only 1.8 percent a year in the
low-income oil importers, com-
pared to 3.4 percent in the middle-
income oil importers and 3.1 per-
cent a year in the industrial coun-
tries (Table 1.1).

Both the relative and the abso-
lute gaps between the richest and
poorest countries will widen in
the years ahead, including the gap
between middle- and low-income
developing countries. If nothing
ter better than the lower scenario can
be achieved, the number of people
living in absolute poverty, now
some 750 million, will increase by
about 100 million people.

Trade
Chapter 3 looks at developing
countries’ trade and its role in
adjustment. The great success of
the 1970s was the export per-
formance of the middle-income, and
especially the semi-industrial,
countries—success that is likely to
continue, provided the industrial
economies do not stagnate or
become more protectionist. But

Table 1.1 Growth of GNP per person, by region, 1960-90

<table>
<thead>
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<th></th>
<th></th>
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<td>0.7</td>
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<td>Africa (sub-Saharan)</td>
<td>175</td>
<td>260</td>
<td>1.7</td>
<td>-0.4</td>
<td>-1.0</td>
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<td>Asia</td>
<td>991</td>
<td>210</td>
<td>1.8</td>
<td>1.1</td>
<td>1.0</td>
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<td>1,710</td>
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<td>East Asia and Pacific</td>
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<td>1,242</td>
<td>4.9</td>
<td>5.7</td>
<td>4.3</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>249</td>
<td>1,820</td>
<td>2.7</td>
<td>3.4</td>
<td>2.3</td>
</tr>
<tr>
<td>North Africa and Middle East</td>
<td>34</td>
<td>850</td>
<td>2.4</td>
<td>2.7</td>
<td>0.0</td>
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<tr>
<td>Africa (sub-Saharan)*</td>
<td>87</td>
<td>520</td>
<td>1.7</td>
<td>0.4</td>
<td>0.0</td>
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<tr>
<td>Southern Europe</td>
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<td>3,070</td>
<td>5.7</td>
<td>2.9</td>
<td>1.7</td>
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<td>790</td>
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<td>Oil exporters</td>
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<td>1,060</td>
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<td>2.7</td>
<td>2.9</td>
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<tr>
<td>All developing countries</td>
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<td>850</td>
<td>3.5</td>
<td>2.7</td>
<td>2.2</td>
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<td>Low-income</td>
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<td>250</td>
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<td>1,580</td>
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<td>2.2</td>
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<tr>
<td>China*</td>
<td>977</td>
<td>260</td>
<td>..</td>
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<tr>
<td>Capital-surplus oil exporters</td>
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<td>Industrial countries</td>
<td>674</td>
<td>10,660</td>
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<td>2.5</td>
<td>2.3</td>
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<tr>
<td>Nonmarket industrial economies</td>
<td>356</td>
<td>3,720</td>
<td>..</td>
<td>3.9</td>
<td>2.8</td>
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</tbody>
</table>

a. Not including South Africa.
b. GNP for China refers to 1979; growth rate is 1970-79.
most of the low-income countries have participated hardly at all in the growth of world trade or in the growing "South-South" trade among developing countries: this is part of the explanation for their current plight. Their terms of trade, even excluding oil, deteriorated badly.

The chapter discusses the need for the industrial countries to tackle their problems of trade adjustment. An open and expanding trade environment is central to the health of the world economy in the 1980s. This is true for the growth of the industrial countries as well as for developing countries, whose exports and credit-worthiness are interconnected. But the chapter concludes that the poorest countries will generally not benefit much from trade unless their development also advances on other fronts.

Energy

A range of energy issues is considered in Chapter 4. It shows that the pattern of energy use and growing demand before the 1973-74 oil-price increase was unsustainable and describes what is needed to return to a sustainable path. It underlines that the two critically scarce fuels in the 1980s are oil and fuelwood. The chapter considers the economic factors governing trends in future energy prices, the changing composition of total energy use, the implications of higher energy prices for developing countries' growth prospects, and the energy policies that developing countries could adopt to reduce their vulnerability.

International capital flows

Chapter 5 of the Report describes how, in the mid-1970s, capital markets efficiently recycled the oil exporters' surpluses, particularly to middle-income developing countries; while bilateral and multilateral aid programs initially responded to the needs of many low-income countries. The 1979-80 oil-price increases mean that heavy additional borrowing is needed to avoid unacceptably low growth rates. But there are now several causes for concern that were absent in the mid-1970s: many countries have already borrowed heavily; the banking system faces a growing number of constraints; and high interest rates will increase borrowing needs if there is to be a substantial net transfer of funds, while shorter maturities will call for more frequent refinancing. These are among the reasons why middle-income countries' requirements may not be met without the increased involvement of the international financial institutions; the latter have in fact already begun to play a more active role.

Once again, however, it is the plight of the low-income countries that most requires new initiatives. They need to borrow more—especially, more rapidly disbursing funds. Yet bilateral and multilateral aid agencies have not—and on present expectations are not likely to—come forward on anything like the scale that is needed. And at least one of the sources of foreign exchange which helped some low-income countries through the 1970s—workers' remittances—is not expected to grow as fast as before. Unless they receive more financial support, and quickly, their prospects are bleak. The result can only be further deprivation in the poorest countries, several of which have already had declining per capita incomes during the 1970s.

National adjustment

Having covered international issues, the Report then moves on to consider domestic questions. Corresponding to each of the facets of global adjustment, national adjustment requires policies that over time, say in five to eight years, will reduce current account deficits to sustainable levels. This means that countries must often reduce consumption below what it would otherwise have been, and generate enough foreign exchange to cover the imports needed for growth by expanding exports or, alternatively, reducing import requirements. To the extent that increased financing is necessary to avoid sudden contraction during the adjustment period, they must be able to attract foreign capital. Patterns of production and consumption of energy must alter both so as to economize on its use and to encourage its domestic supply. In a time of austerity, it is more than ever essential to make the most efficient use of scarce resources in promoting economic and social objectives. In the long term, the strategy of development and the relative rates of expansion of different sectors must respond to higher energy costs and foreign-exchange constraints. Successful adjustment implies achieving this with the minimum sacrifice of income growth and without abandoning the goals of human development and a less unequal distribution of personal incomes.

National adjustment, like global adjustment, takes time. The experience of different countries has varied greatly, as Chapter 6 demonstrates.

- Low-income oil importers. Several have benefited both from internal developments—good harvests, successful adjustment policies—and from external factors (not least those originating directly or indirectly from higher oil prices: more exports to the oil producers, more aid from them, and large workers' remittances).
But the majority of low-income countries were harmed both by international changes (volatile, slow-growing demand for many countries’ primary commodities, aid stagnating after a brief upsurge in 1974–75) and by their long-standing domestic weaknesses. Many were, in addition, racked by war and civil strife.

• Middle-income oil importers. Most of them adjusted fairly well to changed circumstances. Those with advanced manufacturing industry and easier borrowing opportunities could be flexible enough to expand exports and maintain growth. But a few of them—particularly those that borrowed to defer rather than accelerate adjustment, or took on overambitious new investment programs—did so in ways that will produce problems in the 1980s. And the position of some of the less well-off middle-income primary producers is comparable to that of the low-income countries.

• The oil exporters. They comprise some 20 percent of the population of developing countries and benefited from the changes of the 1970s. For many of them, however, extra oil revenues have not been enough to finance all their planned investments and import needs. And all face the particular difficulty of avoiding rapid domestic inflation—which will occur if their expansion plans run ahead of productive capacity for goods or services that cannot be imported. The capital-surplus oil exporters have a special concern over the rate of immigration which has had to accompany their new growth. For all oil exporters, there is a premium on developing human resources and on choosing projects with benefits that will outlive their oil reserves.

Chapter 6 also discusses recent developments in China, which is going through its own period of “adjustment and reform.” And it examines a variety of internal and external factors which are inducing adjustment in the nonmarket industrial economies.

Human development

Last year’s World Development Report was devoted largely to questions of human development. It stressed a number of themes—that mitigating poverty, improving health and nutrition, promoting family planning, raising educational levels and enhancing other living conditions were interrelated goals, important for their own sake; and that the investments required for these purposes were not just humanitarian in their concern but made major contributions to economic growth.

Chapter 7 of this Report restates these themes. It looks first at the likely impact of national adjustment on human development programs, which are obviously at risk at a time of budgetary stringency. It argues that these programs do not have to be cut, or at least not severely; if cuts are inevitable nonetheless, it suggests how they can be effected with the least damage to human development. Unless these programs are maintained, many more millions will live and die in appalling poverty.

Food and nutrition are examined from three main standpoints: the relation between world food supplies and measures to improve food security for countries and for individuals; the conflict in domestic agricultural policy between poor people’s needs for low food prices and the higher prices needed for incentives to farmers; and international and national action necessary to overcome widespread hunger.

The chapter also discusses population issues. If food and other human needs are not met and human development does not advance, that is bad enough in itself. But there is a further consequence. The volumes of research on population in recent years demonstrate clearly that poverty and rapid population growth are linked. Failed development translates directly into failure to slow the rate of world population growth. This reinforces the hardship of developing countries in one of their many vicious circles: the population growth which results from poverty makes the removal of poverty more difficult.

Nor will that hardship necessarily be confined to developing countries. A world of 1.5 billion people in 1900 grew to one of 2 billion by 1975 and will exceed 6 billion by the end of this century. The pressures this will bring to every country will be considerable, since all are affected by world demand for food and for finite resources, and by the dangers to clean air and oceans. Failure to slow population growth substantially by the end of this century means that rapid population growth will continue in the next, and lead to an ultimate world population of 11 billion or more instead of the 8 billion at which it could be stabilized. Any residual belief that industrial countries can somehow immunize themselves from the problems faced in the developing world will then be painfully exposed.

Interdependence

This last theme is one of many instances of interdependence among issues and among countries brought out in this Report. The final chapter provides an overview of interdependence; summarizes the Report; and draws some conclusions on world economic prospects and the policies required to improve them.
Figure 1.1 Three decades of progress: income, health, education, 1950–80

Income

<table>
<thead>
<tr>
<th></th>
<th>1950</th>
<th>1960</th>
<th>1980</th>
</tr>
</thead>
<tbody>
<tr>
<td>GNP per person (1980 dollars)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial countries</td>
<td>4,130</td>
<td>5,580</td>
<td>10,660</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>640</td>
<td>820</td>
<td>1,580</td>
</tr>
<tr>
<td>Low-income countries</td>
<td>170</td>
<td>180</td>
<td>250</td>
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</table>

Average annual growth (percent) 1950–60 1960–80

<table>
<thead>
<tr>
<th></th>
<th>1950–60</th>
<th>1960–80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial countries</td>
<td>3.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>2.5</td>
<td>3.3</td>
</tr>
<tr>
<td>Low-income countries</td>
<td>0.6</td>
<td>1.7</td>
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Health

Life expectancy at birth (years)

<table>
<thead>
<tr>
<th></th>
<th>1950</th>
<th>1960</th>
<th>1979</th>
<th>Increase 1950–79</th>
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<tr>
<td>Industrial countries</td>
<td>67</td>
<td>70</td>
<td>74</td>
<td>7</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>48</td>
<td>53</td>
<td>61</td>
<td>13</td>
</tr>
<tr>
<td>Low-income countries</td>
<td>37</td>
<td>42</td>
<td>51</td>
<td>14</td>
</tr>
<tr>
<td>Nonmarket countries</td>
<td>60</td>
<td>68</td>
<td>72</td>
<td>12</td>
</tr>
</tbody>
</table>

Education

Adult literacy rate (percentage)

<table>
<thead>
<tr>
<th></th>
<th>1950</th>
<th>1960</th>
<th>1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial countries</td>
<td>95</td>
<td>97</td>
<td>99</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>48</td>
<td>53</td>
<td>72</td>
</tr>
<tr>
<td>Low-income countries</td>
<td>22</td>
<td>28</td>
<td>39</td>
</tr>
<tr>
<td>Nonmarket countries</td>
<td>97</td>
<td>97</td>
<td>99</td>
</tr>
</tbody>
</table>

Note: All tables exclude China.

Challenge of development

Future goals must be judged in the light of past achievements. In many countries, independence came less than 20 years ago and economic development has been a formal policy goal for only a relatively short time; yet considerable strides have already been made. Among the middle-income countries, GNP per person has risen almost two-and-a-half times in real terms during the past 30 years, from some $640 in 1950 (1980 dollars) to $1,580 in 1980. In the low-income countries, per capita incomes rose by less than
one-half, from $170 (1980 dollars) in 1950 to $250 in 1980; a gain of only $80 per person in 30 years—though in the great majority of them, significant gains have nonetheless been made in combating illiteracy, in improving education and health, in lowering mortality and fertility.

By contrast—and it is a stark contrast—in that same 1950–80 period the average income per person in the industrial countries increased by over $6,500 (Figure 1.1). These income figures should not be taken too literally—to reflect purchasing power differences, those for developing countries should be adjusted upwards by a factor of 2 or more. Nevertheless, the contrast remains.

Not surprisingly, most developing countries regard industrialization itself as the main path to prosperity, so much so that many of them have paid insufficient attention to complementary primary production, particularly food production. Many middle-income countries owe a considerable part of their growth to expanding output and exports of manufactures. Yet in the low-income countries manufacturing accounts for only 13 percent of GNP, and that is only two percentage points higher than it was 20 years ago. This does not imply that low-income countries cannot progress. Being a low-income country is not an immutable fact; it is a statistical category. The middle-income countries were poor once themselves; some are still only narrowly above the line which separates them from the low-income countries. Some, however, have advanced from a low starting point with striking speed even in the past two decades; and several low-income countries have reasonable prospects of raising their incomes substantially in the years to come.

Thus the questions of this Report are old questions: how can developing countries achieve growth with equity and sustained human development? Will the international environment complement their efforts? But some of the answers and the facts that underlie them are new. In a certain sense, the 1970s may be remembered for giving a new shape to the world economy. This is not the product of the search through negotiation for greater equality of economic opportunity among nations which the developing countries have pursued; little progress has been made along that route. Rather, what has evolved is a different pattern of economic power, with new centers of production, finance and trade, and new forms of interdependence. The result has been both severe difficulties and favorable opportunities for the developing world; the 1980s will determine whether the opportunities can outweigh the difficulties, even for the poorest countries.