

2020 FOCUS BRIEF on the World's Poor and Hungry People

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GLOBAL MACROECONOMIC DEVELOPMENT The Implications for Poverty

Eugenio Díaz-Bonilla

This brief presents an overview of global macroeconomic developments over time and some of their implications for poverty trends in developing countries. It concludes with comments on possible macroeconomic policies to create an environment for sustainable poverty reduction in developing countries.

Growth, Prices, Capital Flows, and Their Impact on Poverty

Growth

High and stable growth is important for poverty alleviation. Although world economic growth declined in every decade from the 1960s through the 1990s, it has picked up somewhat in the 2000s. In particular, world gross domestic product (GDP) per capita grew during 2000–05, mainly because population growth has declined and the performance of per capita GDP in developing countries has strengthened, reaching its highest point in the past half century.

Growth stability is also central for improving poverty trends. Overall, the global economy has gone through four cycles of strong deceleration: 1974–75, 1980–83, 1991–93, and 2001–02. In each of these episodes, the number of developing countries in recession increased significantly; in some cases more than 50 percent of the countries were affected—55 percent in 1982 and 53 percent in 1992. Looking at the averages for each decade, volatility and the number of countries in recession increased during the 1980s and declined in the following decades, reaching their lowest values in the 2000s (Table 1). In general, the numbers indicate that, in the current decade, developing countries have enjoyed relatively high growth with low volatility, which should help with poverty alleviation efforts. It is uncertain how much longer the current benign conditions can be sustained.

Inflation and Interest Rates

Interest rates and inflation have important implications for growth and poverty alleviation. For instance, episodes of hyperinflation, such as occurred in several countries of Latin America and the Caribbean (LAC) in the 1980s and 1990s, were accompanied by sharp increases in poverty. But lower inflation tends to alleviate poverty because the poor have nominal incomes that adjust slowly to change, and they do not have access to financial

instruments that protect them from price increases. In recent decades, the world economy has gone through cycles of rising and falling inflation, with parallel cycles of nominal and real interest rates. Recent low trends should have contributed to alleviating poverty. Since mid-2003, however, nominal and real short-term interest rates have begun to increase, signaling a tightening of monetary policy that may preface a slowdown in global GDP in 2008–09 that could negatively affect poverty levels.

Table 1—World Macroeconomic Indicators

Indicator	1960s	1970s	1980s	1990s	2000s
World					
GDP Growth (% per year)	5.4	4	3	2.7	3
GDP per Capita Growth (% per year)	3.4	2.1	1.3	1.2	1.7
Trade Growth (% per year)	7.6	6.4	4.7	6.2	6.7
Trade as a Share of GDP (%)	24.5	32.2	37.6	41.3	48.6
Developing Countries					
Total Growth (% per year)	4.9	5.3	3.4	3.4	5.2
Per Capita Growth (% per year)	2.7	3.1	1.4	1.8	3.9
Share in Recession (%)	28.5	29	40.6	35.8	18.9
Capital Inflows (% GDP)	n.a.	1.25	1.06	1.44	1.11
Consumption Volatility	0.91	0.78	1.03	0.80	0.64
Inflation (% per year) ^a					
Industrialized Countries	4.9	8.7	6.2	2.8	2
Developing Countries	4.9	16.2	36.7	36.1	5.8
Interest Rates (%)					
Nominal ^b	6	8.4	10.6	5.5	3.2
Real ^c	1	-0.3	4.1	2.7	1.1

Sources: World Bank, *World Development Indicators* (Washington, DC, various years); International Monetary Fund, *IFS* (Washington, DC, various years).

Notes: Growth is aggregated at market exchange rates. Consumption volatility data represent a median of five-year rolling average of standard deviation/average growth for developing countries. For the 1960s, data cover various years. For the 2000s, data on GDP, trade growth, interest rates, and inflation are for 2000–05.

^aConsumption index.

^bLIBOR dollar deposits six months.

^cUsing industrialized-country inflation rates.

Commodity Prices

Many of the poorest developing countries and several of the middle-income ones depend on exports of a relatively small number of commodities. Therefore, price developments in these products tend to have a large impact on production, incomes, employment, fiscal accounts, and poverty in those

Table 2—Commodity Real Price Indexes (2000 = 100)

Commodity	1960s	1970s	1980s	1990s	2000–05	2005–07
Food	206.9	220.0	143.9	106.1	102.2	104.7
Agricultural Raw Materials	111.1	110.9	85.1	94.4	94.0	91.6
Beverages	292.2	297.9	190.8	113.0	95.3	105.8
Oil	23.6	60.8	103.8	57.3	106.3	158.8
Metals	138.6	134.6	113.5	91.5	103.6	186.4

Sources: See Table 1.

Note: Values are deflated by the export unit value of industrialized countries.

countries. World commodity prices have experienced important changes in real terms over these decades (Table 2).

During the 1960s and 1970s prices of agricultural products (particularly food and beverages) were high in real terms. Oil prices jumped significantly during the mid- to late 1970s. In the early 1980s the world macroeconomic environment changed markedly, leading to a sharp decline in world growth. Nominal and real prices of many commodities declined, and during the 1990s real prices of many commodities were about half the levels of the 1960s and 1970s or less. Real prices of commodities remained on a lower plateau for much of the 1990s. Depressed world prices of food and agricultural products during the 1980s and 1990s—in part also related to agricultural protectionism and subsidies in industrialized countries—appear to have discouraged investments in the rural sector of many developing countries, with negative consequences for the poor, who mostly reside there. Low food prices seem to have also pushed several developing countries into a more extreme specialization in tropical products, increasing their external vulnerability and transforming many of them into net food importers that came to depend on subsidized food from abroad.

Once the world resumed growth after the deceleration in the early 2000s, some commodities, particularly metals and oil, began to climb again, and in 2005–07 actually surpassed the peaks achieved in the 1970s (in real terms). The current situation for agricultural commodities is different, however, in the sense that real prices for those products have stayed well below the higher levels of the 1960s and 1970s.

Capital Flows and Debt

Capital flows to developing countries have gone through two cycles (see Box 1). The first peaked in the early 1980s at more than 2 percent of the combined GDP for developing countries; it then declined during the debt crisis of the 1980s to a minimum of 0.6 percent of GDP in 1986. The second cycle began in the early 1990s; peaked in 1995 at about 2 percent; and dropped again during the sequence of developing-country crises of the late 1990s and early 2000s, reaching a low of 0.8 percent of GDP in 2002. In the early 2000s, capital flows began to increase again. It remains to be seen how the latest cycle of capital flows will play out over the rest of this decade.

The behavior of capital flows has several implications for the economy, for tradable sectors (like agriculture), and for the poor. Capital inflows usually affect growth and investment positively, but overvaluation of the domestic currency can hurt tradable sectors. Capital flows can experience sudden reversals, which may lead to depreciation of the domestic currency, banking and fiscal crises (when domestic private and public debt in dollars is widespread), and sharp declines in growth. Therefore, ebbs and flows of capital to developing countries have been associated with booms and busts in those countries.

During the upswing, the impact on the poor will depend on their position in the economy and the nature of the growth process generated by those capital inflows. In principle, the urban poor and those working in nontradable sectors would benefit more than the rural poor during periods of growth associated with continued inflows of capital. However, if growth is sustained, benefits accrue to all the poor, albeit to different degrees. When changes in financial markets lead to sudden outflows of capital and growth collapses, the welfare of the urban poor and those working in nontradable sectors tends to suffer the most.

Macroeconomic Policies for Poverty Reduction

Growth cycles and volatility in developing countries since the 1960s have been greatly influenced by policies in industrialized countries that determine global macroeconomic conditions, such as interest rates, capital flows, and commodity prices. The main global macroeconomic issue today is whether an adjustment will be made in the U.S. current account (which has reached the unprecedented level of about 2 percent of world GDP), with a corresponding correction in the surplus countries, and what form it will take. A cooperative adjustment maintaining world growth would require an expansion of domestic demand among Asian countries (particularly China and Japan), oil producers, and a variety of developing countries, along with appreciation of their exchange rates. The European Union is more advanced in the adjustment process, through its expanding demand and appreciation of the Euro. On the other side of the rebalancing equation, both households and the government in the United States would have to increase domestic savings (reducing domestic demand), while the real exchange rate also depreciates.

Box 1—Growth, Capital Flows, and Poverty Trends: Global Experience from the 1960s to the 2000s

The 1960s and 1970s

The 1960s and 1970s were years of high growth, moderate inflation, low (and even negative) real interest rates, accelerated expansion of trade, and high real prices of commodities. The economic buoyancy of those years was based on expansionary macroeconomic policies in many countries and stable exchange rates coupled with the expansion and liberalization of trade at the international level. LAC and Sub-Saharan Africa (SSA) were the two fastest growing regions during the 1960s, and they continued to grow strongly during the 1970s, although East Asia's growth began to overtake all developing regions at this time. For the period since the 1960s to the early 1980s, the World Bank, in its 1990 *World Development Report*, considered that there had been "considerable progress in reducing the incidence of poverty, a more modest reduction in the number of poor, and achievement of somewhat better living standards for those who remained in poverty" (p. 40).

The 1980s

In the case of many developing countries, high commodity prices during the 1970s allowed them to borrow against what was considered to be ample export revenues, setting the stage for the debt crises of the 1980s. The breakdown of the Bretton Woods system of fixed but adjustable exchange rates and the oil shocks of the second half of the 1970s drastically changed world macroeconomic conditions. Countries that had borrowed against expectations of high commodity prices, mainly in LAC and Africa, entered a period of debt distress and economic crises that increased poverty. Asian countries—which were gradually specializing in manufacturing goods, becoming importers of primary products and, over time, becoming the main recipients of capital flows—were less affected and eventually benefited from the decline in prices of commodities. Poverty trends went hand in hand with the overall economic growth performance of the different developing regions. Poverty dropped significantly in East Asia and South Asia (regions that were clearly outperforming other developing countries in growth rates), but increased in LAC and SSA.

The 1990s

The American recession at the end of the 1980s, coupled with low real interest rates in industrialized countries, sent capital flowing back to developing countries in the first half of the 1990s, with Asia becoming now a more prominent destination. However, U.S. monetary policies initiated a period of tightening in the second half of the 1990s, and capital flows to developing countries stopped and reversed once interest rates and the dollar value began to increase in the second half of the 1990s. A second wave of developing-country debt crises erupted first in Mexico in 1995, then in several countries of East Asia in 1997, Russia in 1998, Brazil in 1999, and Argentina in 2001. The sudden emergence of financial crises and the subsequent disruption of the economies of many Asian and South American countries had both direct and indirect effects on the poor. For the countries affected, the financial crises had clear negative impacts on poverty: the median value of the percentage of poor people living on less than US\$1 per day increased from 5.2 percent before the crises to 7.3 percent after them, and the percentage of people living on less than US\$2 per day jumped from 23 to almost 28 percent.

The 2000s

Global growth has been strong since the early 2000s, pushing up real prices of commodities such as metals and energy. In the 2000s, capital has been flowing from developing countries toward industrialized countries (excluding Japan), mainly to the United States, where the large current account deficit—and its sustainability—remains an important concern for the performance of the global economy. While high commodity prices of the 1970s prompted many developing countries to borrow against that collateral, in the 2000s these countries have been improving their fiscal and external accounts, reducing their debts, and increasing the availability of savings for the rest of the world. Also, East Asian countries decreased investments and turned to positive current accounts, adding to world excess net savings. So far, strong growth and lower inflation and volatility have translated into a decline of poverty (as a percentage of the population) in all developing regions. However, uncertainties remain due to imbalances in the world economy and doubts about the sustainability of growth patterns in the main engines of current growth, particularly the United States.

The potential for a disorderly and traumatic adjustment is also present: a strong recession in the United States could accomplish the rebalancing through internal adjustment, as happened in the early 1980s and early 1990s. Or the adjustment could be forced by external factors if investors and financiers of the U.S. current account deficit were to significantly reduce their demand for dollar-denominated assets. In the benign scenario, the demand in the rest of the world expands, and the dollar depreciates slowly, whereas, in the traumatic scenario, U.S. demand drops far more precipitously, and the dollar requires a further depreciation against those currencies now floating more freely against it (like the Euro).

Either way, growth in the rest of the world will be negatively affected, increasing poverty in developing countries. In general, such downturns have been associated with recessions and economic crises in many developing countries. At the global level, it seems clear that there are no international institutions that can enforce a cooperative solution to the current imbalances. Discussions at the International Monetary Fund (IMF) have focused on the possibility of strengthening economic policy surveillance that encourages cooperation. Yet the IMF currently does not have the instruments or the governance system to design and implement such an outcome. The same applies to other multilateral bodies, such as an expanded G-7 or the Financial

G-20. In any case, developing countries should prepare for a turn in the world business cycle in the relatively near future, as happened with the global slowdowns in the early 1980s, 1990s, and 2000s.

All these macroeconomic uncertainties and challenges short, medium, and long term raise the question of what developing countries should do. At the macroeconomic level, it is important to try to smooth the business cycle and to avoid economic crises, if developing countries want to reduce poverty and hunger. To that effect, developing countries should (1) strengthen the fiscal positions of their public sectors, thus reducing public-sector debt ratios, using additional resources from high commodity prices counter-cyclically, and creating fiscal space to establish safety nets for the poor and vulnerable; (2) avoid rigid and appreciated real exchange rates that may lead to trade imbalances and excessive accumulation of external debt; and (3) maintain a reasonable level of reserves in the central banks as a precaution against possible global turbulences that could lead to declines in growth and commodity prices, possibly stopping capital flows to developing countries. In general, many developing countries seem to have been following these policies more closely than in the cycles that ended in debt crises in the 1980s and 1990s.

It should be noted that, on the one hand, an economic slowdown would also reduce demand for energy, alleviating the currently tight markets for those products. On the other hand, a continuation of strong world growth would most likely lead to further increases in energy prices, which could trigger a future slowdown directly, or indirectly, through policy reactions in key countries aimed at lowering inflation. This will also have negative implications for poverty

in developing countries. It should be remembered that oil prices were about US\$20 per barrel in 2001—the beginning of the current growth cycle—but prices reached more than US\$80 per barrel in the second half of 2007. As in the 1970s, the current period of relatively high growth, mostly fueled by middle-income countries, may end up generating an additional price shock to energy products, with negative impacts for welfare and poverty in many developing countries.

Even without accelerated growth, potential imbalances loom in world energy markets in the coming years, and, in the longer term, the implications of energy consumption for climate change may carry significant and troubling consequences for many developing countries. The complex issues linking energy use, economic development, poverty alleviation, and climate change are also affected by a significant market-coordination failure of global proportions, which—like the shorter term macro-imbalances—lacks a widely accepted international mechanism for resolution. Therefore, in the longer term, the prospects for economic development and poverty and hunger alleviation in developing countries are directly tied to the fair resolution of another imbalance beyond the scope of this brief: how to make sure that the world's population has adequate access to sustainable energy resources.

For Further Reading: S. Chen and M. Ravallion, "How Have the World's Poorest Fared since the Early 1980s?" World Bank Research Working Paper 3341 (Washington, DC: World Bank, 2004); International Monetary Fund, *World Economic Outlook* (Washington, DC, various issues); World Bank, *Global Economic Prospects* (Washington, DC, various issues); and World Bank, *World Development Report 1990: Poverty* (Washington, DC, 1990).

Eugenio Díaz-Bonilla (diazbonilla@iadb.org) is executive director for Argentina and Haiti at the Inter-American Development Bank.

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INTERNATIONAL FOOD POLICY RESEARCH INSTITUTE

2033 K Street, NW, Washington, DC 20006-1002 USA

T: +1 202 862 5600 • F: +1 202 467 4439
ifpri@cgiar.org • www.ifpri.org



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