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BREAKING THROUGH THE FRONTIER: CAN TODAY'S DYNAMIC LOW-INCOME COUNTRIES MAKE IT?

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Key Points

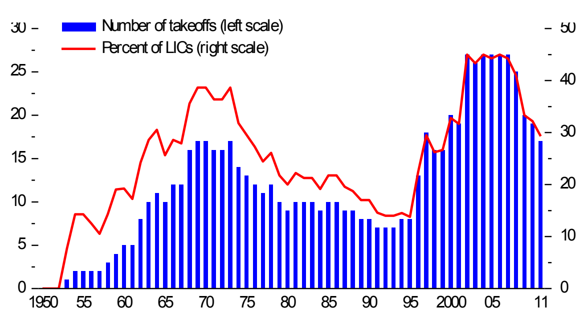
- The growth performance of low-income countries (LICs) has improved markedly in the past two decades, with a rising share of strong growth takeoffs. One concern is whether this development is resilient or whether it will be followed by disappointment, as was the case for some countries that took off in the 1960s and the early 1970s.
- The chapter compares this recent wave of dynamic LICs with the previous wave, primarily dynamic LICs in the 1960s and 1970s, and finds:
    - *Important similarities:* Both achieved stronger investment rates and export growth than LICs that were unable to takeoff.
    - *Striking differences:* Today's dynamic LICs sustained growth with much lower economic vulnerabilities than dynamic LICs in the past. This reflects in part greater reliance on foreign direct investment than on debt-financed investment, as well as faster implementation of structural reforms.
- Thanks to their stronger policies and lower vulnerability, today's dynamic LICs should be in a better position to manage the risk of economic reversal that afflicted many dynamic LICs in the past. But further progress calls for vigilance against macroeconomic imbalances and sustained structural reform.

LICs have come back with a second wave of growth takeoffs, but one concern is whether this stronger performance will endure. Specifically,

- *Takeoffs have rebounded*. After a first wave of growth takeoffs—defined as an expansion in LIC per capita output lasting at least five years with average growth of at least 3½ percent—in the 1960s and early 1970s, takeoffs fell subsequently, but rebounded again in the past two decades.
- *Recent takeoffs lasted longer* than takeoffs prior to the 1990s, and more than half of today's dynamic LICs continued to expand during the Great Recession.
- *Recent takeoffs are about more than commodities.* About one-third of recent

Frequency of New and Ongoing Takeoffs in Low-Income Countries

The share of low-income countries starting and sustaining growth takeoffs increased sharply beginning in the 1990s. More than half of these dynamic LICs (comprising one-third of all LICs) maintained their takeoffs in 2011, despite the global slowdown since the Great Recession.



Source: IMF staff calculations.

takeoffs occurred in manufacturing-oriented LICs (Bangladesh, Cambodia) or in LICs without any dominant sector (Mozambique, Tanzania). The remaining two-thirds were resource-rich (Ghana, Mongolia) or agricultural (Ethiopia) or both (Lao P.D.R). Although resource-rich dynamic LICs in the current generation have seen the strongest growth thus far, many LICs rich in resources failed to take off. Prior to the 1990s, takeoffs in resource-rich LICs were eventually overtaken by others, and among the LICs that did not take off, the resource-rich had the slowest growth.

- *But there is concern about reversals.* Although dynamic LICs in both generations tended to see their income per capita rise by 50 to 60 percent in the 10 years following takeoff, some dynamic LICs in the previous generation slowed sharply over time and even experienced reversals in income gains. Thus, a key question for today is whether recent takeoffs are less vulnerable than those in the past.

Takeoffs highlight the key roles of capital accumulation and trade integration in development: takeoffs in both generations were accompanied by higher investment and saving rates and larger export growth compared with LICs that did not take off.

However, dynamic LICs in the second wave will benefit from a stronger economic footing compared with those in the previous generation. These LICs experienced declines in inflation and debt after takeoff, and their real exchange rates were more competitive, whereas the previous generation experienced widening imbalances after takeoff. Lower debt accumulation in the current generation reflects both greater reliance on foreign direct investment and continued strong growth despite lower investment than in the previous generation. These LICs also achieved a stronger record on structural and institutional reforms, such as a lower regulatory burden, better infrastructure, higher education levels, lower income inequality, and greater political stability.

History confirms the value of continued efforts to lower economic and financial fragilities. Although case studies show that LICs were able to take off by reducing internal and external imbalances, not all of them could sustain their efforts. Countries that persistently addressed economic weaknesses or implemented broad-based structural reforms enjoyed sustained growth (Indonesia and Korea in the 1960s to the 1980s). Where imbalances widened, takeoffs ended disruptively or were interrupted even after decades of strong growth (Brazil in the 1980s, Indonesia in the 1990s). A key lesson for LICs today is to avoid procyclical policies and too much external debt, particularly against the backdrop of ultralow global interest rates.

Today's dynamic LICs' policy achievements are a good sign, but they must still address many challenges. Strong growth must be accompanied by broad-based improvements in living standards, health and education, and a decline in poverty. Many LICs will also need to diversify further to protect themselves from the risks arising from the concentration of growth in only a few sectors. However, if these LICs can preserve their improved policy foundation and structural reform momentum, they are more likely to stay on course to meet their development goals and avoid the setbacks that afflicted many dynamic LICs in the past.