Indicators of Economic Welfare in Four Groups of Countries, 1997

Income group	GNP per capita (U.S. dollars)	Life expectancy (years)*
Low-income	350	59.0
Lower middle-income	1,230	68.5
Upper middle-income	4,520	69.5
High-income	25,700	77.5

*Simple average of male and female life expectancies.

Source: World Bank, *World Development Report 1998/99.*

The Gap between Rich and Poor

The world's economies can be divided into four main categories according to their annual per-capita income levels: low-income economies (including India, Pakistan, and their neighbors, along with much of sub-Saharan Africa); lower middle-income economies (including mainland China, the smaller Latin American and Caribbean countries, many former Soviet bloc countries, and most of the remaining African countries); upper middle-income economies (including the largest Latin American countries, Saudi Arabia, Malaysia, Turkey, South Africa, Poland, Hungary, and the Czech and Slovak Republics); and high-income economies (including the rich industrial market economies and a handful of exceptionally fortunate "developing" countries such as Israel, oil-rich Kuwait, and Singapore). The first three categories consist mainly of countries at a backward stage of development relative to industrial economies. Table 22-1 shows 1997 average per-capita annual income levels (measured in dollars) for these country groups, together with another indicator of economic well-being, average life expectancy at birth.

Table 22-1 illustrates the sharp disparities in international income levels close to the end of the twentieth century. Average per-capita GNP in the richest economies is 73 times that of the average in the poorest developing countries! Even the upper middle-income countries enjoy only about one-sixth of the per-capita GNP of the industrial group. The life expectancy figures generally reflect international differences in income levels. Average life spans fall as relative poverty increases.[1]

Has the World Income Gap Narrowed over Time?

Explaining the income differences between countries is one of the oldest goals of economics. It is no accident that Adam Smith's classic 1776 book was entitled the *Wealth of Nations*! Since at least the days of the mercantilists, economists have sought not only to explain why countries' incomes differ at a given point in time, but also to solve the more challenging puzzle of why some countries become rich while others stagnate. Debate over the best policies for promoting economic growth has been fierce, as we shall see in this chapter.

Both the depth of the economic growth puzzle and the payoff to finding growth-friendly policies are illustrated in Table 22-2, which shows per-capita output *growth rates* for several country groups between 1960 and 1992. Over that period, the United States grew at roughly the 2 percent rate that many economists would argue is the long-run maximum for a mature economy. Canada, which was 27 percent poorer than its southern neighbor in 1960, has grown at a higher rate since then, so that by 1992 it was only 9 percent behind—thereby having closed the earlier income gap by two-thirds.

Canada's catching-up process illustrates a more general phenomenon: the tendency for gaps between *industrial* countries' living standards to disappear over the postwar era. The theory behind this observed convergence in per-capita incomes is deceptively simple. If trade is free, if capital can move to countries offering the highest returns, and if knowledge itself moves across political borders so that countries always have access to cutting-edge production technologies, then there is no reason for international income differences to persist for long.

Despite the appeal of that simple theory, no clear tendency for per-capita incomes to converge characterizes the world as a whole, as the rest of Table 22-2 shows. There we see vast discrepancies in long-term growth rates among different regional country groupings, but no general tendency for poorer countries to grow faster. Countries in Africa, although mostly at the bottom of the world income scale, have grown at rates far below those of the main industrial countries.[2] Growth has also been relatively slow in Latin America, where only a few countries have matched the growth rate of Canada, despite much lower income levels.

In contrast, East Asian countries *have* tended to grow at rates far above those of the industrialized world, as the convergence theory would predict. South Korea, with an income level close to Ghana's in 1960, has grown at almost 7 percent per year since then and in 1997 was classified as a high-income developing country by the World Bank. Singapore's 6.6 percent annual average growth rate likewise propelled it to high-income status.

Table 22-2 Output Per Capita in Selected Countries, 1960–1992 (in 1985 U.S. dollars)

Country	1960	1992	1960–1992 Annual growth rate (percent per year)
North America			
Canada	7,240	16,371	2.6
United States	9,908	17,986	1.9
Africa			
Ghana	886	956	0.2
Kenya	646	915	1.1
Nigeria	560	978	1.8
Senegal	1,062	1,145	0.3
Latin America			
Argentina	4,481	4,708	0.2
Brazil	1,780	3,886	2.5
Chile	2,897	4,886	1.6
Mexico	2,825	6,250	2.5
East Asia			
Hong Kong	2,231	16,461	6.4
Malaysia	1,409	5,729	4.5
Singapore	1,626	12,633	6.6
South Korea	898	6,665	6.9
Thailand	940	3,924	4.6
Taiwan	1,255	8,067	6.4

A country that can muster even a 3-percent annual growth rate will see its real per-capita income double every generation. But at the growth rates seen until recently in East Asian countries such as Hong Kong, Singapore, South Korea, and Taiwan, per-capita real income increases *fivefold* every generation! As detailed later in this chapter, rapid growth came to a halt in East Asia in the late 1990s as a severe financial crisis erupted.

What explains the sharply divergent long-run growth patterns in Table 22-2? The answer lies in the economic and political features of developing countries and the ways these have changed over time in response to both world events and internal pressures. The structural features of developing countries have also helped to determine their success in pursuing key macroeconomic goals other than rapid growth, such as low inflation, low unemployment, and financial-sector stability.