

# ISSUES AND FACTS ON DEVELOPMENT

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## The Current Issue:

*Slipping up the Income Ladder*

By *Heloisa Marone*

Income per capita in low and middle income economies has grown recently at unprecedented high rates. Part of this growth correlates with the windfall of oil revenues that have flowed to some developing countries. Some of the prosperous oil-producing countries are also some of the poorest countries in the world. The massive oil revenue flowing into these economies could be an asset but also a huge managerial and political challenge.

## Facts at a Glance:

*In Search for Renewable Energy*

By *Heloisa Marone and Nina Thelen*

Renewable energy sources are on the rise but what do we really know about the facts behind this trend?

*Rising Food Prices and the Inflation Scare*

By *Heloisa Marone*

Will decade low inflation rates in many developing countries be reversed by soaring demand for crops?

## About

### *Issues and Facts on Development*

*Issues and Facts on Development* is a brief issued by the Office of Development Studies (ODS), United Nations Development Programme. The new publication takes on up-to-date topics in the area of development and shows them in a new light. It consists of a main feature titled “the current issue” and a number of mini features headed “facts at a glance”.

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## THE CURRENT ISSUE

### Slipping up the Income Ladder

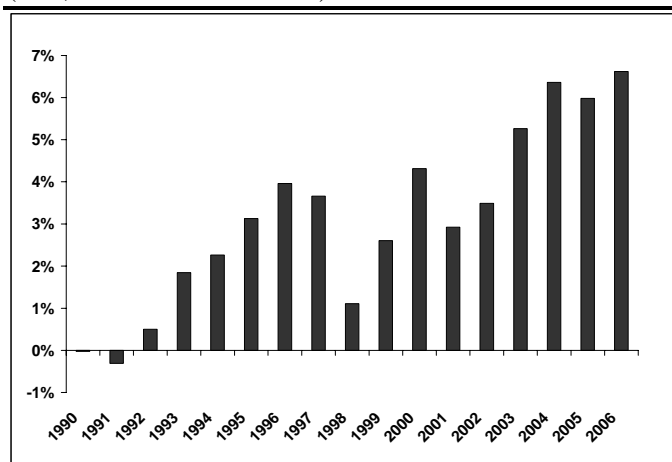
By Heloisa Marone

Growth in income per capita of low and middle income economies as a group has accelerated in recent years. Between 2004 and 2006, it is estimated that the region grew on average more than 6.3 percent annually in real and per capita terms; almost double the average growth rate in the preceding 10 years (see Chart 1). This boost in real income per capita was due to a combination of smaller inflation rates and an unprecedented increase in the income per capita in the southern region in the period between 2004 and 2006.

In the summer of 2007, the World Bank announced the new country classification based on the 2006 GNI per capita, calculated using the World Bank Atlas method. Among other changes, Brazil and Kazakhstan were re-classified as upper middle economies, while Bhutan and the Democratic Republic of the Congo were moved to the lower middle income category. In 2006 the classification thresholds were as follows: low income, \$905 or less; lower middle income, \$906 - \$3,595; upper middle income, \$3,596 - \$11,115; and high income, \$11,116 or more.

Chart 1

**Growth in Income per Capita, Middle and Low Income Countries**  
(PPP, in constant 2000 US\$)



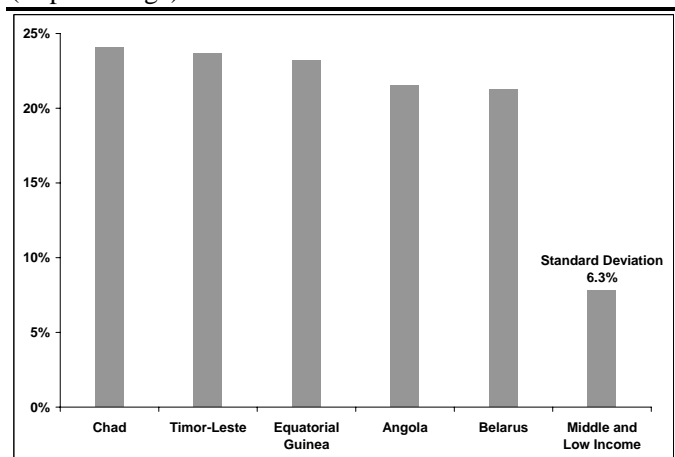
Source: The World Bank's World Development Indicators Online.

Between 2004 and 2006, among the top five countries showing the largest step up in the World Bank's income ranking were: Chad and Timor-Leste among the low income group, Equatorial Guinea among the upper middle

income group, and Angola among the lower middle income group (see Chart 2).

Chart 2

**Largest Average Annual Movements Upward the World Bank's Income ranking, 2004-2006**  
(In percentage)



Note: Income scale is defined as high income threshold minus the sum of low and middle income thresholds.

Source: Own computation based on the World Bank's World Development Indicators Online.

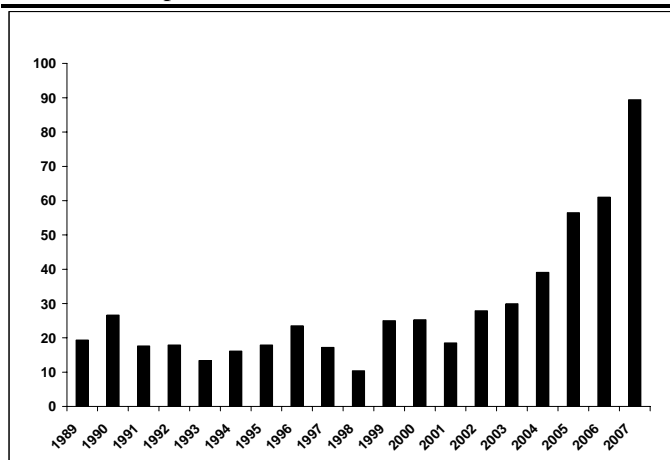
In common these economies have the fact that they are largely based on oil and gas production. Indeed, according to the IMF, oil represented almost of 40 percent of Chad's GDP in 2005, a 10-fold jump from the 4 percent share in 2002. The IMF also estimates that more than 80 percent of Equatorial Guinea's GDP came from the oil-gas sector in 2005 and almost 60 percent of Timor-Leste's and Angola's respective GDPs are oil-gas related. This highlights the importance of gas and, in particular, oil wealth among some countries in the southern region.

The extraordinary increase by these economies in the income per capita ranking should come as little surprise considering the steep increase in oil prices since early 2000 (see Chart 3). Moreover, some of these countries are new oil producers - this is the case of Chad where production started in 2003 - or saw their production facilities increased - which is the case of Angola. In some cases, large moves up the income ladder may also be related to the recovery from long periods of internal conflict.

What is more surprising perhaps is the fact that three out of these four countries are among the poorest countries in the world according to the UNDP's human poverty index (UNDP Human Development Report 2007/2008). Indeed, Chad is the poorest, Timor-Leste is in the bottom 15 percent, and Angola is in the bottom 22 percent of a total of 108 developing countries. Moreover, Chad and Angola are countries with low human development according to the UNDP's human development index. Can the poor population in some of these countries benefit from the oil windfall?

In Chad, for instance, according to the IMF, while the oil production accounts for a significant part of the GDP, the bulk of population depends on cotton, livestock, and small-scale agriculture and is vulnerable to external and climate shocks.

Chart 3  
**Crude Oil (petroleum) Prices**  
 (Current US\$ per barrel)



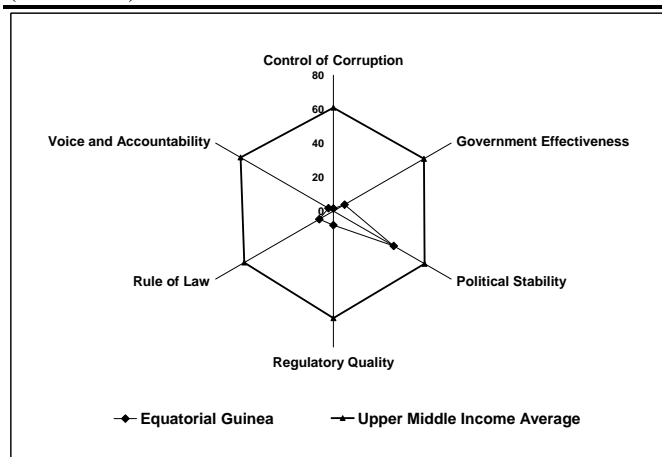
Note: Simple average of three spot prices: Dated Brent, West Texas Intermediate, and the Dubai Fateh.  
 Source: IMF.

The mass of money from oil revenue flowing into these economies constitutes not just an asset but also a huge managerial and political challenge. While these inflows of money provide an unprecedented opportunity for development, especially for poor countries that often face financial constraints, they also face serious obstacles. At the macroeconomic management level, "Dutch disease" may be a concern. More fundamentally, the long (and expanding!) literature on "the resource curse" shows that more daunting challenges include state capture, corruption, distorted incentives towards pursuing rents as opposed to productive investment, and so on. Weak administration and political structures are likely to exacerbate these challenges, preventing this bout of prosperity to be long-lived and to be

channeled into effective ways to combat poverty and inequality.

Strong governance may mitigate the risks of mismanagement, especially if accompanied by sustainable political contracts that prevent government capture and distortions of the public policy goals of pursuing development and reducing poverty. Governance indicators (limited as they may be) suggest that all four countries - Equatorial Guinea, Angola, Chad, and Timor-Leste - exhibit a "deficit" in governance when compared to their income level peers (Charts 4, 5, and 6). Indeed, Timor-Leste is the only exception in terms of government effectiveness and voice and accountability, where it scores higher than its low income peers. A recent IMF report supports Timor-Leste's government growth strategy that rests on a substantial increase in public investment, made possible by surging oil revenue and high levels of donor assistance. The report warns, however, that there is no guarantee that overall growth will benefit the poor. The violence outbreak in early 2006 and the recent attacks on the two highest-ranking officials in Timor-Leste in which the President was seriously wounded further suggest political stability is not a given.

Chart 4  
**Governance Indicators, Equatorial Guinea and Upper Middle Income Group, 2004-2006**  
 (Percentile)

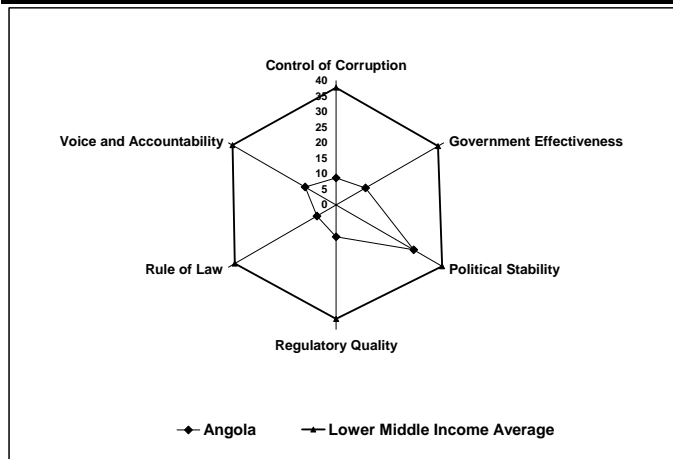


Note: Numbers indicate the rank of a country among all countries in the world; 0 being the lowest rank and 100 the highest.  
 Source: World Bank's Worldwide Governance Indicators 1996-2006.

As noted, all four countries score very low relative to their income peers in terms of corruption control, rule of law, and political stability; all of which are part of the fundamentals of a sounding governance structure. As the literature on the resource curse has shown, greater wealth

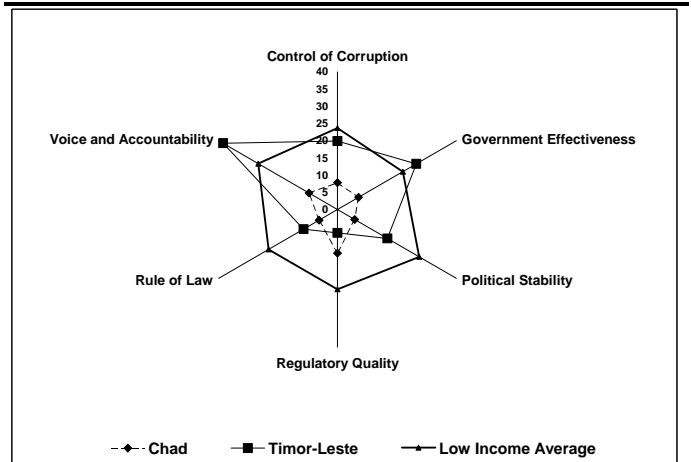
becomes a drawback when it weakens the incentives for governments to push for economic and democratic reforms.

**Chart 5**  
**Governance Indicators, Angola and Lower Middle Income Group, 2004-2006**  
 (Percentile)



*Note:* Numbers indicate the rank of a country among all countries in the world; 0 being the lowest rank and 100 the highest.  
*Source:* World Bank's Worldwide Governance Indicators 1996-2006.

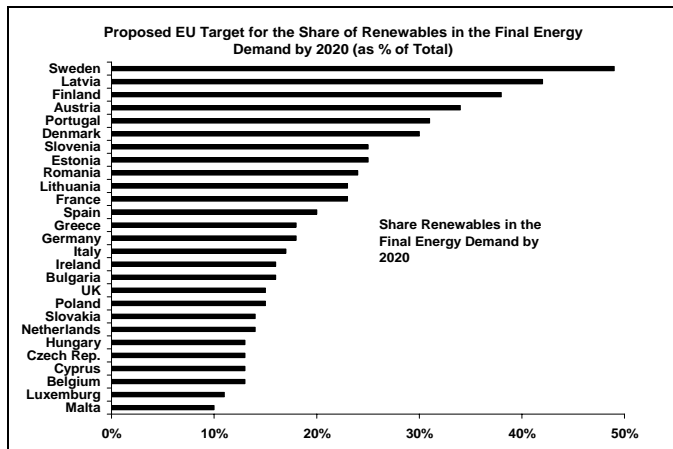
**Chart 6**  
**Governance Indicators, Chad, Timor-Leste, and Low Income Group, 2004-2006**  
 (Percentile)



*Note:* Numbers indicate the rank of a country among all countries in the world; 0 being the lowest rank and 100 the highest.  
*Source:* World Bank's Worldwide Governance Indicators 1996-2006.

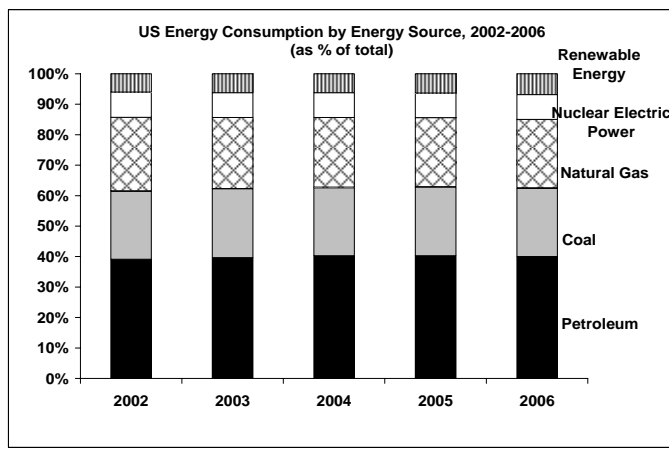
# FACTS AT A GLANCE

## In Search for Renewable Energy *By Heloisa Marone and Nina Thelen*



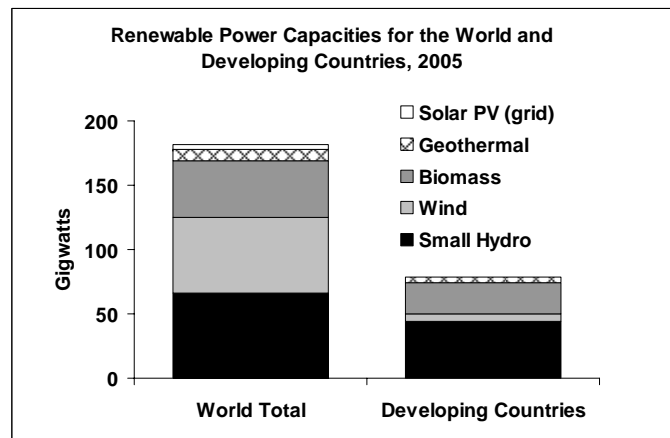
Source: European Commission. Climate Action Proposal, 23 January 2008.

Earlier in 2007, the European Council had set two key targets, to which the Commission is now proposing a way of implementing. The two targets were: First, a reduction of at least 20 percent in greenhouse gases (GHG) by 2020 (from the 1990 level) – rising to 30 percent if there is an international agreement committing other developed countries. Second, a 20 percent share of renewable energies in EU energy consumption by 2020 (including a 10 percent biofuels target).



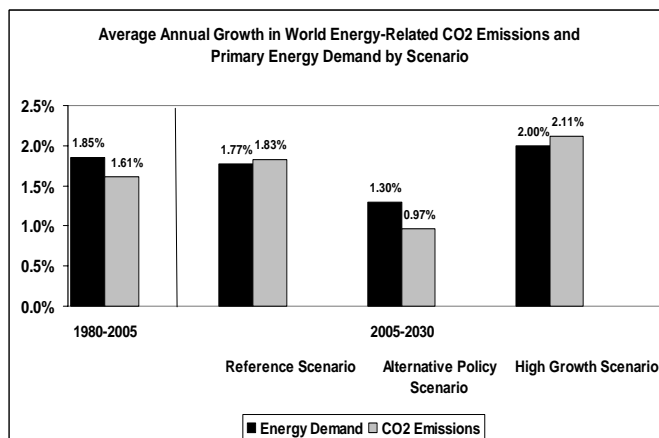
Source: Non-renewable energy: Energy Information Administration (EIA), Monthly Energy Review (MER) May 2007.

The US is highly dependent on fossil fuels, which represent more than 85 percent of total US energy consumption. The share of renewable energy constituted less than 7 percent of total US energy consumption in 2006. Of the total power originated from renewable energy sources, 48 percent comes from biomass and 42 percent from hydroelectric power. An economy with technologies that are so used to fossil fuels may take a while to diversify into other sources of energy.



Source: Renewable Energy Policy Network for the 21st Century 2006.

Worldwide power capacity generated from renewable energy sources went up in 2005 to 182 GW, from 160 GW in 2004 (excluding large hydropower). It is estimated that the share capacity in developing countries remained constant compared to 2004, at 44 percent. The main contributors in the developing world are China (small hydro) and India (wind). In 2005, renewable power capacity including large hydropower was almost 5 times smaller than total electric power capacity (4,100 GW in 2005).

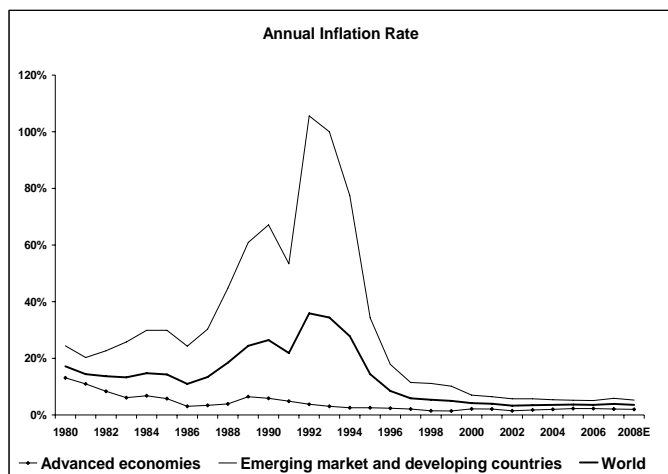


Source: OECD/IEA 2007.

The Reference Scenario takes into account those government policies and measures that had already been adopted by mid-2007. The Alternative Policy Scenario is based on those policies and measures that countries are currently considering and are assumed to adopt and implement, taking account of technological and cost factors, the political context and market barriers. The High Growth Scenario sheds light on the global impact of faster than expected economic growth in China and India (OECD/IEA 2007).

# Rising Food Prices and the Inflation Scare

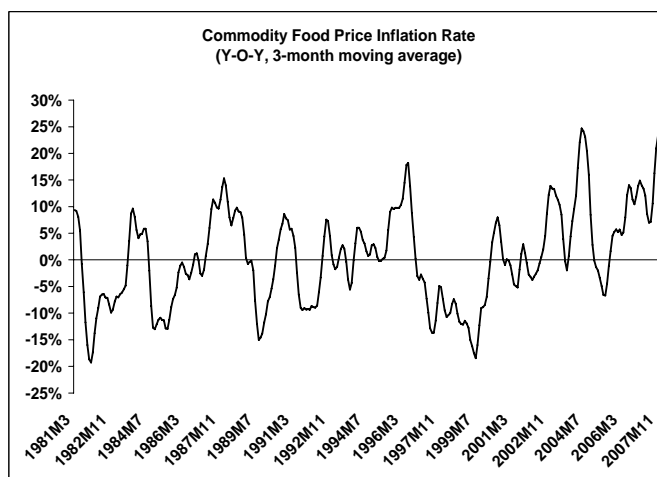
By Heloisa Marone



Source: IMF.

Emerging market and developing countries aggregate inflation rate reached 5.1 percent in 2006, the lowest rate since 1980, and more than 1/20 smaller than the peak of 106 percent in 1992. Not all developing countries are following this trend.

The inflation rate in Zimbabwe, which is the only country excluded in this sample, is estimated to have reached 16,170.2 percent in 2007. Zimbabwe's inflation rate has been driven by higher energy and food costs associated with shortage of supply in the domestic market. Moreover, the inflation has been amplified by a drop in its currency. Economists believe that these price increases will continue because Zimbabwe will be forced to import corn, a basic food staple, to make up for a lack of home-grown produce.



Note: Commodity Food Price Index includes Cereal, Vegetable Oils, Meat, Seafood, Sugar, Bananas, and Oranges Price Indices.  
Source: Own computation based on IMF statistics.

More recently food prices have jumped sharply. In December 2007, the annual inflation rate reached 24 percent, one of the highest rates since 1981. The increase in prices is a response to a larger global demand.

These prices could continue to rise as industrial countries become keener on the use of bio-fuels derived from crops. The bad news is that food is a much larger component of the consumer price index in many poorer countries. Indeed, in many low-income countries, food comprises 50 percent or more of the consumer basket. This means that the same global increase in the prices of corn, wheat, milk, and meat immediately becomes higher inflation in poorer countries. As a matter of fact, the United Nation's agency responsible for relieving hunger recently announced that it is drawing up plans to ration food aid in response to the spiraling cost of agricultural commodities.