HIGHLIGHTS FROM CHAPTER 4: FALLING GRADUATION PROSPECTS: LOW-INCOME COUNTRIES IN THE TWENTY-FIRST CENTURY

Key Points

- *Low-income countries' (LICs) graduation to middle-income status has slowed markedly since 2010 amid heightened conflict, frequent economic crises, and feeble growth.*
- *Barring a sustained improvement in growth rates, only six of today's 26 low-income countries appear on track to achieve middle-income status by 2050.*
- *Today's LICs can take inspiration from past LICs that were able to kick-start transformative growth accelerations. Such accelerations were generally preceded by growth-friendly reforms that tended to embrace markets more, while enhancing macroeconomic stability and supporting investment growth.*
- *Today's LICs will also need to overcome formidable challenges. These include heightened risks of debt distress, elevated levels of violence and instability, advancing climate change, and a more difficult external environment.*
- *LICs nonetheless have untapped potential. With sufficient investment in human capital, expanding, youthful populations could be a powerful growth driver, complemented by resources from LICs' endowments of commodities and other natural wealth.*
- *National policy makers can improve growth prospects in LICs by prioritizing policy shifts shown to foster greater investment and stability: prudent fiscal policies, deeper trade integration, and improved governance and monetary frameworks.*
- *The international community can play a key role by providing greater support in the form of technical assistance, greater concessional financing, and in some cases debt relief.*

The rate at which low-income countries (LICs) are attaining to middle-income status has slowed. In 2000, 63 emerging market and developing economies (EMDEs) were classified as low-income countries (LICs). They were home to more than 60 percent of the 1.8 billion people worldwide in extreme poverty. Since then, 39 of those countries have graduated to middle-income status, becoming LICs-turned-middle-income (LTMs). Yet the rate at which LICs are climbing the income ladder has also slowed markedly (figure A). Twenty-four countries that were LICs at the turn of the century remain so, with annual per capita incomes below $1,145 in 2023. South Sudan and the Syrian Arab Republic have joined their ranks, raising the total to 26 LICs today. These countries comprise more than 40 percent of people currently living in extreme poverty.

On recent trends, all but six of today's LICs are likely to remain low-income through 2050. The economic challenges confronting LICs have intensified in the last 15 years amid deadlier conflict and violence, climate shocks, debt crises, and anemic growth. In today's LICs as a whole, real per capita GDP has barely grown since 2010 (figure B). Traditional modes of structural transformation have stalled. As a consequence, extreme poverty has ceased falling in LICs (figure C). Moreover, at average 2010-2019 growth rates, only six LICs would be expected to graduate to middle income by 2050 (figure D). This would represent less than one-quarter of eligible countries, down sharply from the nearly two-thirds that advanced in the first quarter of this century.

Generating growth accelerations can fast-track LIC graduation. With political stability and supportive policies, LICs can achieve transformative growth accelerations—sustained spells of stronger growth, when output becomes more investment- and trade-intensive. Since 1990, 26 growth accelerations have been achieved from low income levels, during which real per capita GDP typically increased by close to 7 percent annually. These accelerations lasted nearly 16 years on average, with investment-to-GDP ratios rising by about 8 percentage points, and the agricultural employment share declining rapidly. Accelerations were often preceded by reforms that prioritized investment and improved the business environment. A baseline of political stability has been essential, but even countries riven by conflict have sometimes entered accelerations relatively soon after peace was achieved. In some cases, international debt relief also played an important role.

Today's LICs will need to overcome formidable challenges. The post-pandemic period has seen conflict and violence in LICs escalate. Today's LICs are also especially vulnerable to climate change, in part reflecting heavy reliance on agriculture in these countries. The distance of most LICs from large and wealthy markets represents a further headwind. Meanwhile, LIC governments lack the fiscal space to undertake the much-needed investments. Domestic impediments to growth are compounded by a less favorable external environment than was enjoyed by LTMs, characterized by trade fragmentation, geopolitical tensions and slower global potential growth.

Yet, LICs enjoy untapped potential that could catalyze stronger long-term growth. LICs have natural endowments which, properly harnessed, could drive higher living standards. LIC working-age cohorts are growing, in contrast to much of the rest of the world. Investments in the health and education of these workforces could propel higher per capita incomes and create a virtuous cycle of stronger investment growth. In some LICs, commodity wealth could generate resources to smooth this process. In other LICs, improved stability and infrastructure could unlock tourism potential. Most LICs also have favorable geography for low-cost solar energy. And with LICs concentrated in Sub Saharan Africa, regional trade integration could deepen export potential.

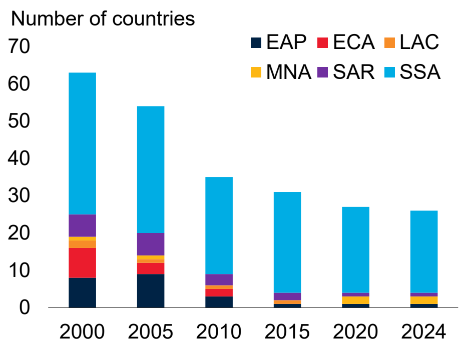
National policy interventions can improve LIC graduation prospects. Most LICs can improve growth prospects by prioritizing policies that foster investment: prudent fiscal stances, deeper trade integration, and improved governance and monetary frameworks. Given the predominance of agriculture and services in LIC employment, a specific focus on raising productivity in promising areas of these sectors warrants attention. In addition, many LICs face specific binding constraints. For LICs in debt distress, increased fiscal space will be a critical enabler of other reforms. For commodity dependent LICs, improved natural-resource governance is essential. For countries in conflict, attaining relative peace and stability is a prerequisite for economic progress.

Greater support from the international community is essential. Even with conducive policies, LICs will need greater international assistance to put development goals on track. Coming even close to meeting investment needs and resolving debt challenges will require a significant pick-up in official development assistance, which declined following the 2020 global recession (figure E). More broadly, it is essential to recognize that the most promising period for LICs this century was the 2000s—a time of trade liberalization and increased global integration and cooperation (figure F). The reembrace of a rules-based international trading system—and the constructive resolution of geopolitical tensions—could do much to improve prospects in LICs.

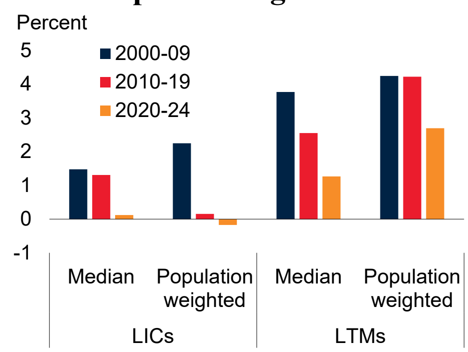
FIGURE. Growth and graduation prospects in low-income countries (LICs)

The rate at which LICs are graduating to middle-income status has slowed markedly since 2010. Geographically, LICs are concentrated in Sub-Saharan Africa. Per capita GDP has near-flatlined for 15 years in LICs, while in LTMs it has decelerated more modestly. Progress on poverty reduction has also stalled in LICs. At 2010-19 average growth rates, less than a quarter of LICs would be on course to graduate to middle-income status by 2050. Recently, total grants to LICs have declined, even as International Development Association financing has increased. Transformative LIC growth accelerations were far more prevalent in the 2000s than today.

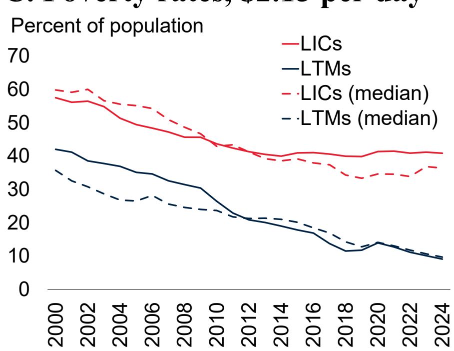
A. Number of LICs



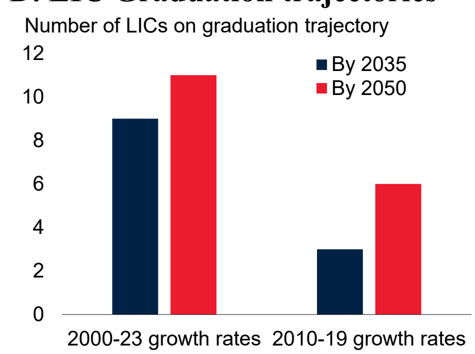
B. Per capita GDP growth



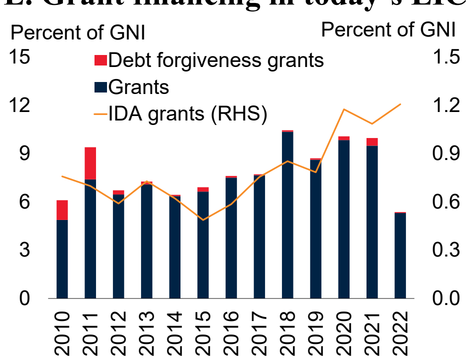
C. Poverty rates, $2.15 per day



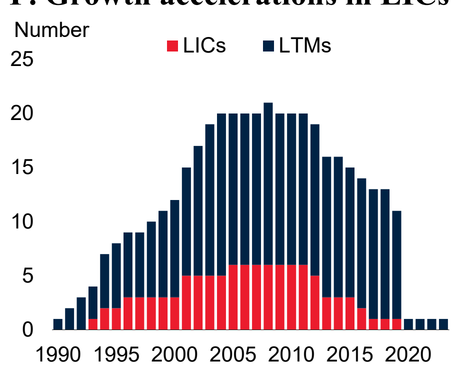
D. LIC Graduation trajectories



E. Grant financing in today's LICs



F. Growth accelerations in LICs and LTMs



Sources: Gootjes et al. (2024); International Debt Statistics (database); Mahler, Yonzan, and Lakner (2022); WDI (database); World Bank Poverty and Inequality Platform (database); World Bank.

Note: EAP = East Asia and the Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MNA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa. LICs = low-income countries; LTMs = LICs turned into middle-income countries.

A. LICs count includes the Democratic People's Republic of Korea.

B.GDP aggregates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. GDP per capita population weighted aggregates are calculated as aggregated GDP divided by aggregate population. Median growth rates represent the median annual average growth rate for each country group in each period.
C. Solid lines represent population-weighted poverty rates in country groups. Dotted lines indicate the median poverty rate in each group each year.
D. Graduation trajectories assume that the threshold for middle-income status increases at the same pace as it has on average since 2000.
E. Grants are defined as legally binding commitments allocating funds for disbursement without any requirement for repayment. Data are on a disbursement basis and cover flows from all bilateral and multilateral donors. International Development Association (IDA) grants are net disbursements of grants from IDA.
F. The number of accelerations depicted beyond 2016 may be low as any new accelerations will not yet be captured—a minimum of eight years of growth data is required to identify the start of an acceleration.