Fiscal Vulnerabilities in Low-Income Countries: Evolution, Drivers, and Policies

November 2024

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Fiscal Vulnerabilities in Low-Income Countries

Main Messages

Large needs; Few means; Urgent Action

- ***LICs have large development needs.*** The world's 26 poorest economies host about 40 percent of all people in extreme poverty. They are deeper in debt than at any time since 2006 and increasingly vulnerable to natural disasters and other shocks. They are poorer today, on average, than they were on the eve of COVID-19.
- ***Weak fiscal positions.*** Fiscal deficits surged in the pandemic, to 3.4 percent of GDP in 2020. LICs have been unable fully unwind these deficits: they stood at 2.4 percent of GDP in 2023, nearly three times the average of other EMDEs. The sizable primary deficits that have driven the debt buildup in these economies have reflected expenditure pressures amid persistent revenue weakness. At the same time, external financing has collapsed.
- ***Policy priorities are clear.*** LICs need to implement well-designed and ambitious policies, focused particularly on revenue mobilization, improving expenditure efficiency, and modernizing debt management practices. International cooperation and larger financial support via IDA and other international institutions can help both stabilize fiscal positions and facilitate structural reforms in LICs.

Four Questions

1. **How have fiscal positions evolved in LICs?** *Fiscal positions have deteriorated in LICs, and even more sharply since the pandemic recession.*

2. **What have been the main sources of the recent deterioration in LIC fiscal positions?** *The deterioration reflects expenditure pressures and revenue weakness. External financing, both official development assistance and other flows, have dwindled.*

3. **How do adverse shocks affect fiscal positions in LICs?** *Global recessions and intense conflict events are both associated with weaker primary balances in LICs. The costs of natural disasters and of adapting to climate change are both larger in LICs than in other EMDEs.*

4. **Which policies can help improve LIC fiscal positions?** *Domestic reforms can support tax policy and tax administration, improve expenditure efficiency, modernize debt management, and spur growth. The international community can complement these reforms with greater financial support and tailored technical assistance to bolster institutional frameworks and improve fiscal outcomes.*

- ***LICs = Low-Income Countries***

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Four Questions

1 How have fiscal positions evolved in LICs? *Fiscal positions have deteriorated in LICs, and even more sharply since the pandemic recession.*

- *LICs = Low-Income Countries*

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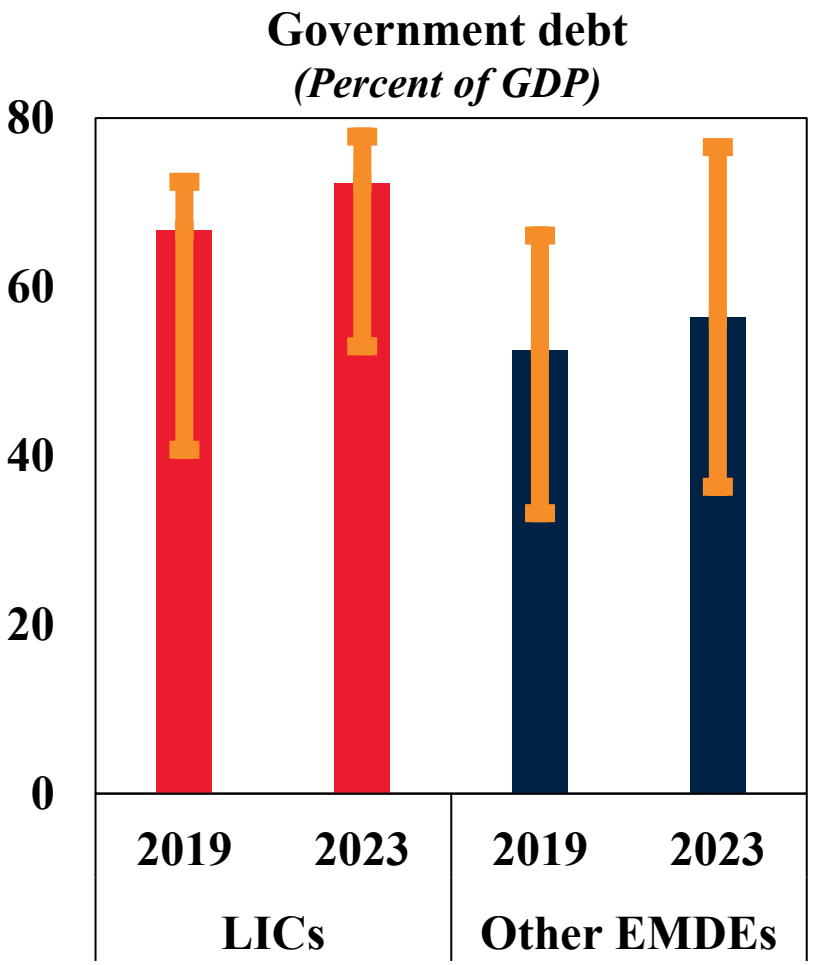
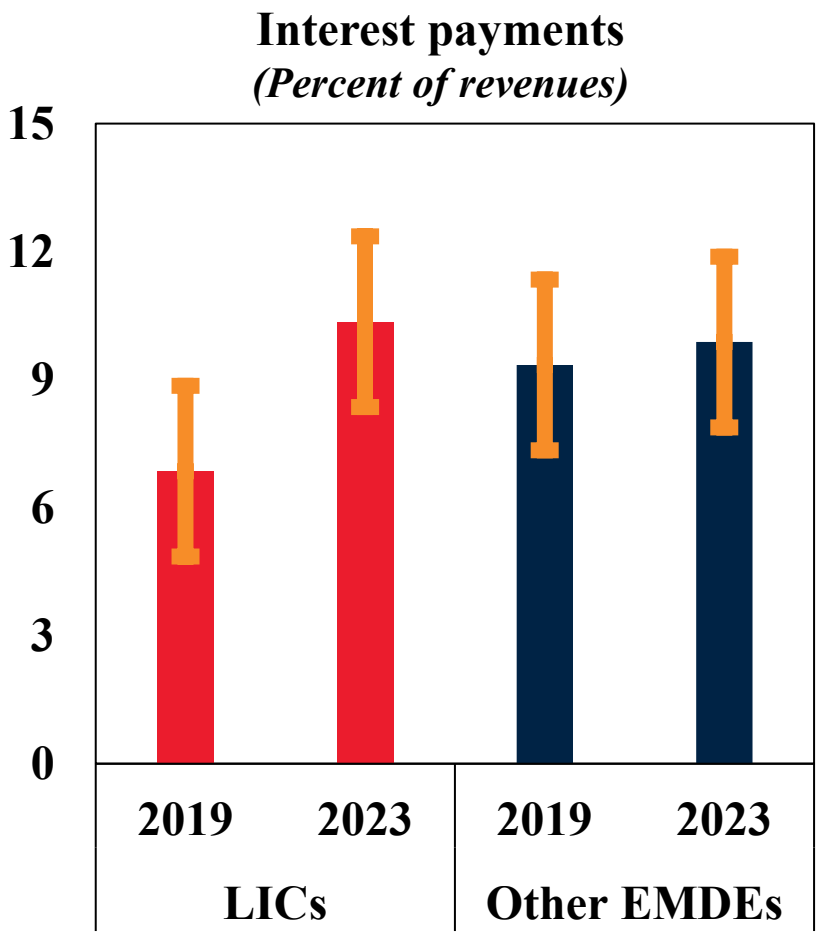
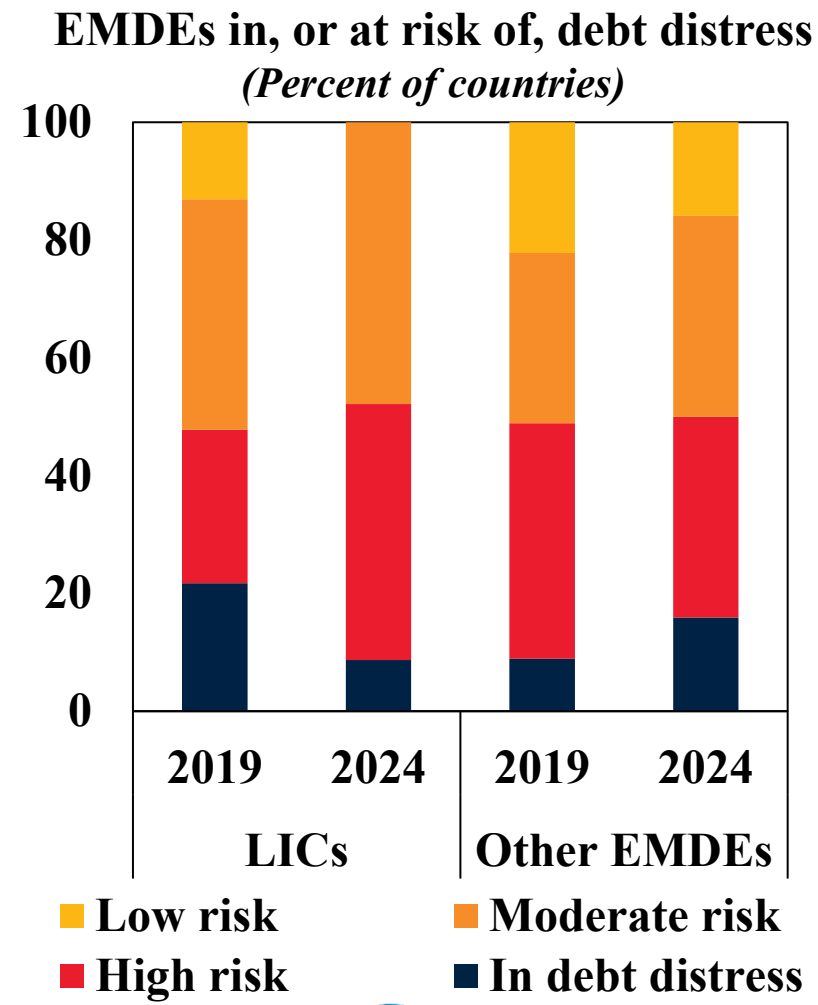
Fiscal Vulnerabilities in Low-Income Countries

Higher Government Debt and Interest Payments; Larger Share Facing Debt Distress







Sources: International Monetary Fund; International Debt Statistics (database); World Bank.

Note: LICs=low-income countries; Other EMDEs= emerging market and developing economies excluding LICs. Left Panel: Bars show the unweighted averages. Orange whiskers show the interquartile ranges. Center Panel: Net interest payments are defined as the difference between the primary balance and the overall balance. Unweighted average. The orange whiskers show interquartile ranges. Right Panel: Percent of EMDEs in, or at risk of, debt distress. Based on 70 EMDEs of which 24 are LICs.

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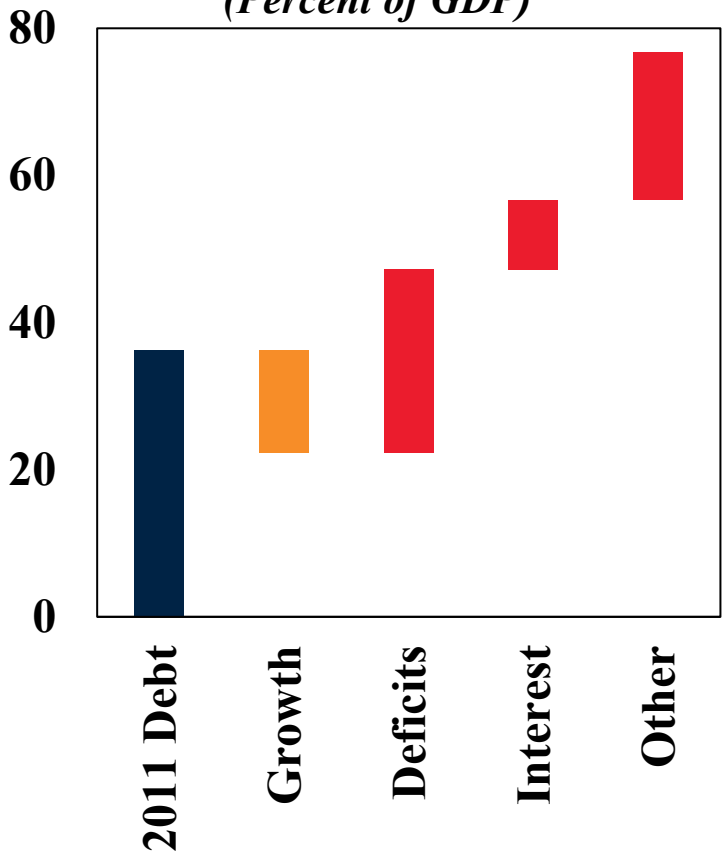
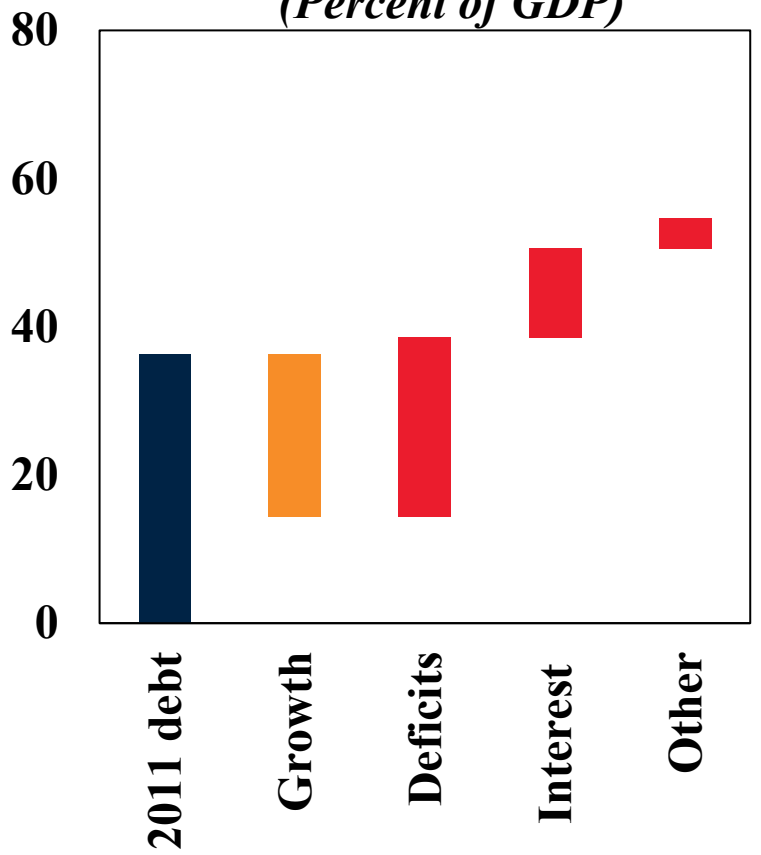
Decomposition of Changes in Government Debt

Large contribution of primary balances; higher than expected interest costs

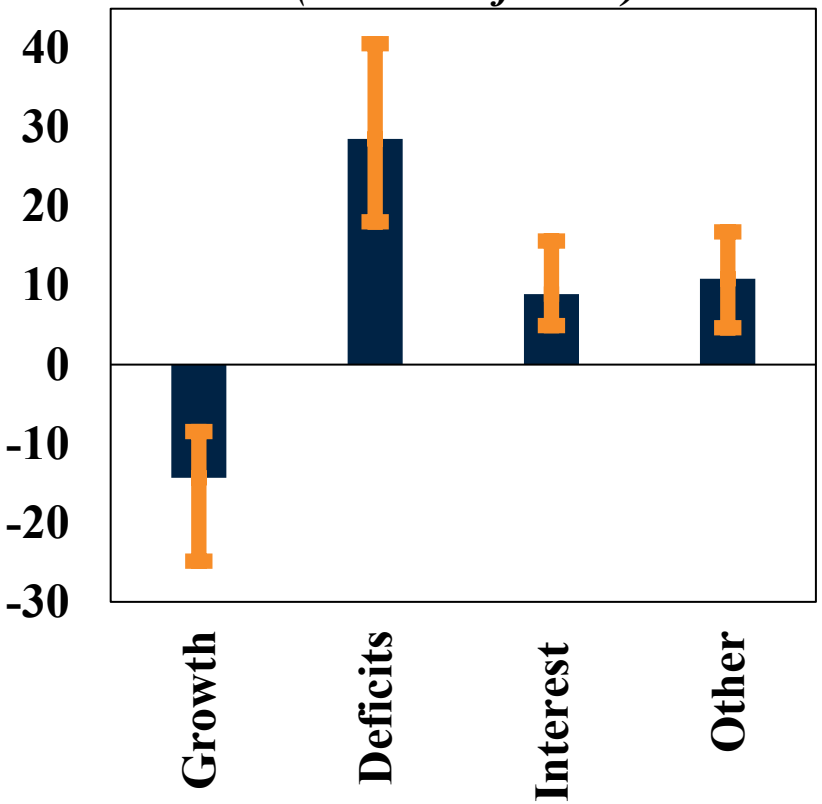
Changes in Government debt in LICs, 2011-23
(Percent of GDP)



Changes in Government debt in LICs, expected in 2018
(Percent of GDP)



Contributions to changes in Government debt in LICs
(Percent of GDP)



Sources: International Monetary Fund; World Bank.
Note: LICs=low-income countries; "Other" factors include exchange rate depreciation, privatization proceeds, the materialization of contingent liabilities or other ad-hoc changes to debt stocks. Left Panel: Red bars indicate debt-increasing contribution and orange bars indicate debt-reducing contribution. Center Panel: Red bars indicate debt-increasing contribution and orange bars indicate debt-reducing contribution. Right Panel: Blue bars indicate the median contributions to the average changes in government debt-to-GDP rations during 2011-23, and orange whiskers indicate interquartile ranges.

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Four Questions

2 **What have been the main sources of the recent deterioration in LIC fiscal positions?** *The deterioration reflects expenditure pressures and revenue weakness. External financing, both official development assistance and other flows, have dwindled.*

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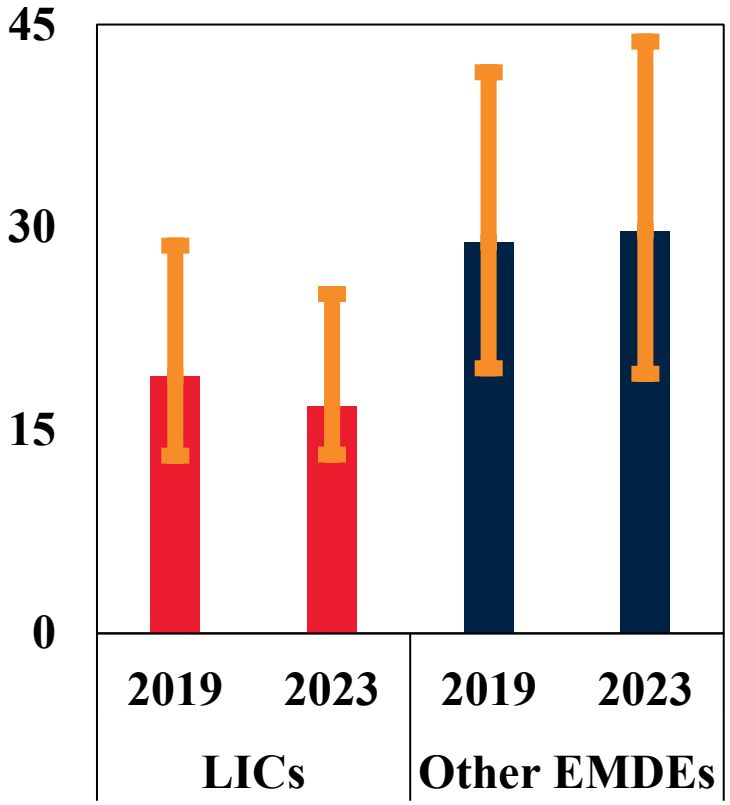
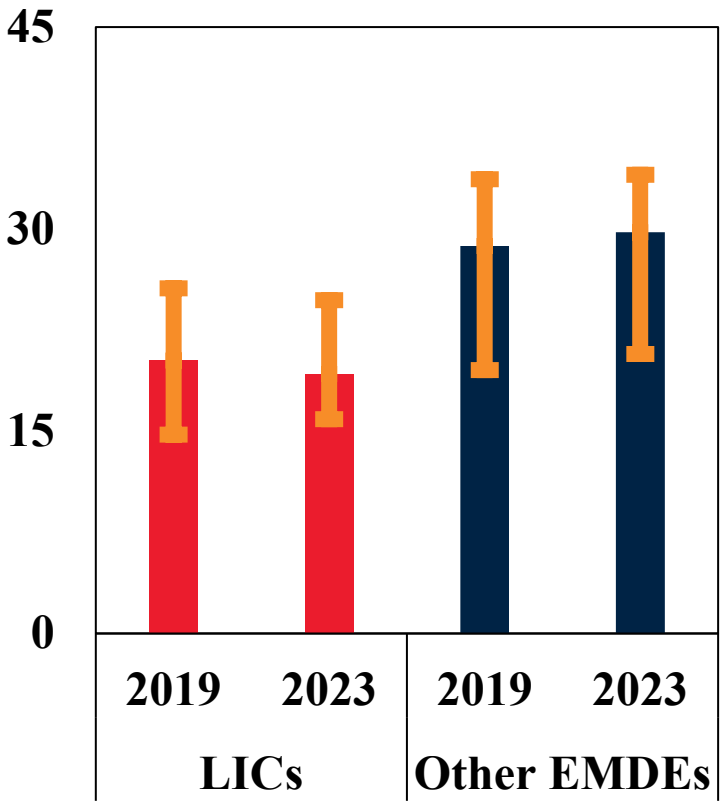
Sources of fiscal deficits in LICs

Persistent revenue weakness; rigid expenditures

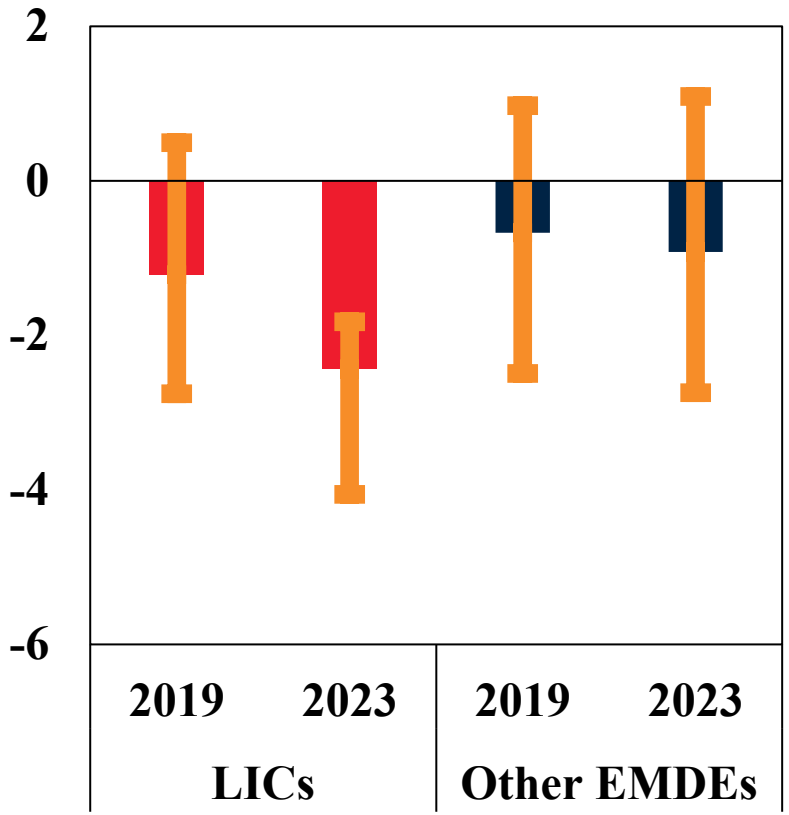
Government Revenue
(Percent of GDP)



Primary Expenditure
(Percent of GDP)



Primary balances
(Percent of GDP)



Sources: International Monetary Fund; World Bank.
Note: LICs=low-income countries; Other EMDEs= emerging market and developing economies excluding LICs. Left Panel: Bars show the unweighted averages. Orange whiskers show the interquartile ranges. Center Panel: Net interest payments are defined as the difference between the primary balance and the overall balance. Unweighted average. The orange whiskers show interquartile ranges. Right Panel: Bars show unweighted averages, with whiskers showing interquartile ranges.

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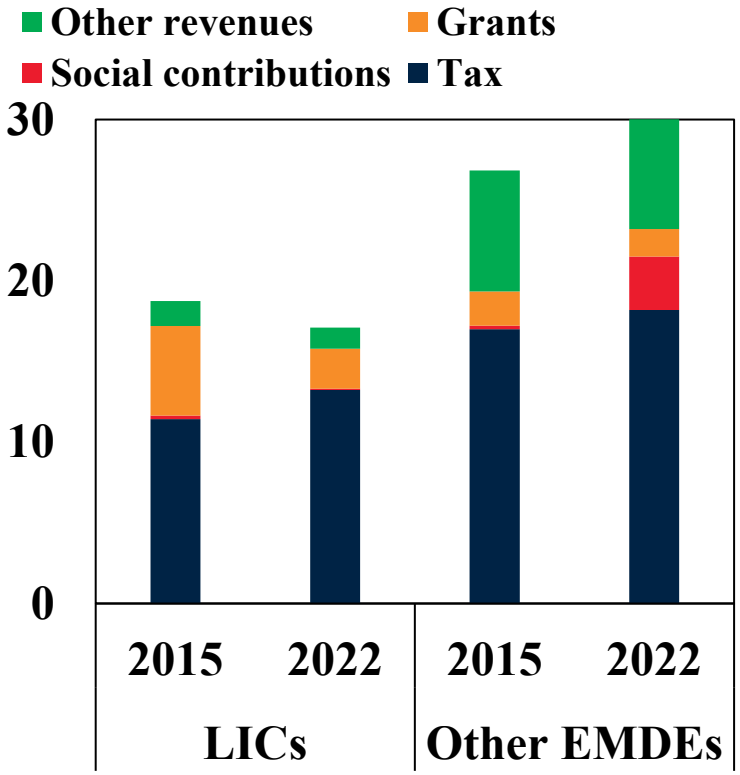
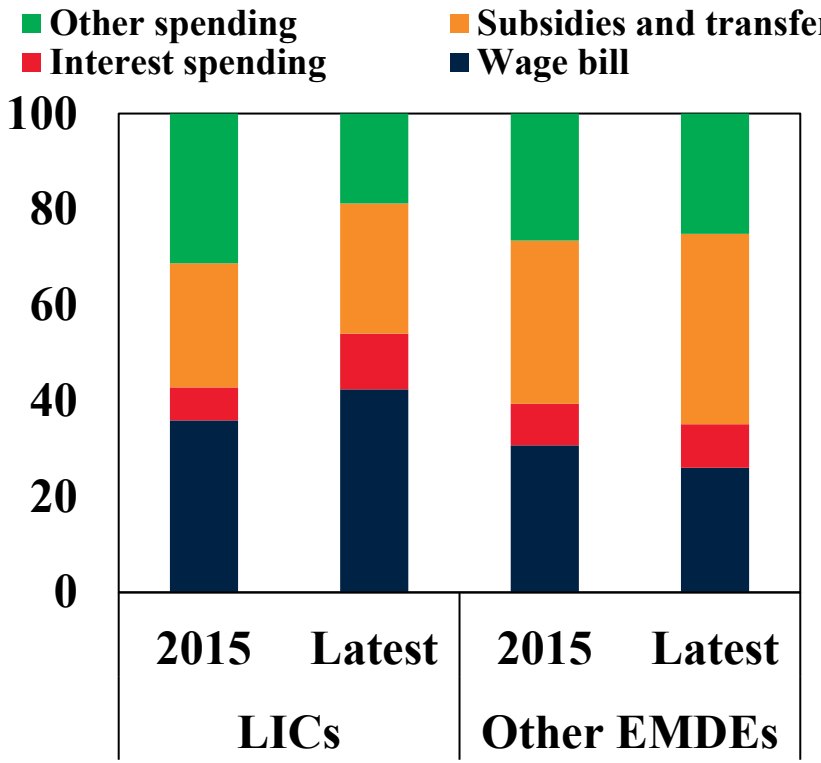
Revenue mobilization composition and expenditure categories

Low Revenue Mobilization; Low Expenditure Efficiency in LICs

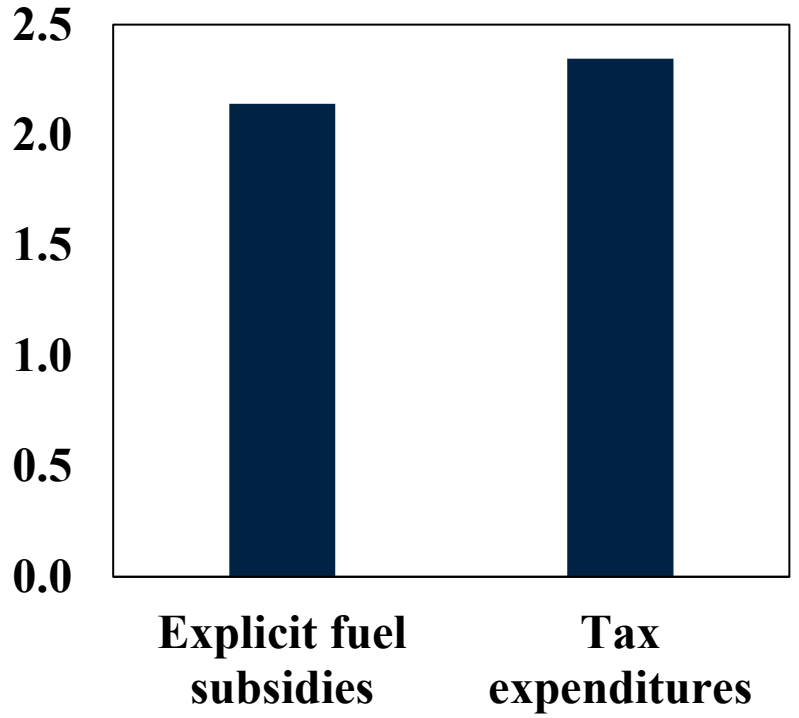
Composition of total revenues
(Percent of GDP)



Composition of government spending
(Percent of expenditure)



Fuel subsidies and tax expenditures
(percent of GDP)



Sources: Global Tax Expenditures (database); International Monetary Fund; World Bank; World Bank;
Note: LICs = low-income countries; EMDEs = emerging market and developing economies; Other EMDEs= emerging market and developing economies excluding LICs. Left Panel: Unweighted averages. Based on up to 134 EMDEs, of which 20 are LICs. Center Panel: Expense excludes net investment in government nonfinancial assets. Right Panel: Bars show weighted averages. Fuel subsidy data are from Black et al. (2023). Based on a sample of 133 EMDEs, of which 21 are LICs. Tax expenditures data is from the Global Tax Expenditures (database). Based on 71 EMDEs, of which 12 are LICs.

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Four Questions

3 **How do adverse shocks affect fiscal positions in LICs?** *Global recessions and intense conflict events are both associated with weaker primary balances in LICs. The costs of natural disasters and of adapting to climate change are both larger in LICs than in other EMDEs.*

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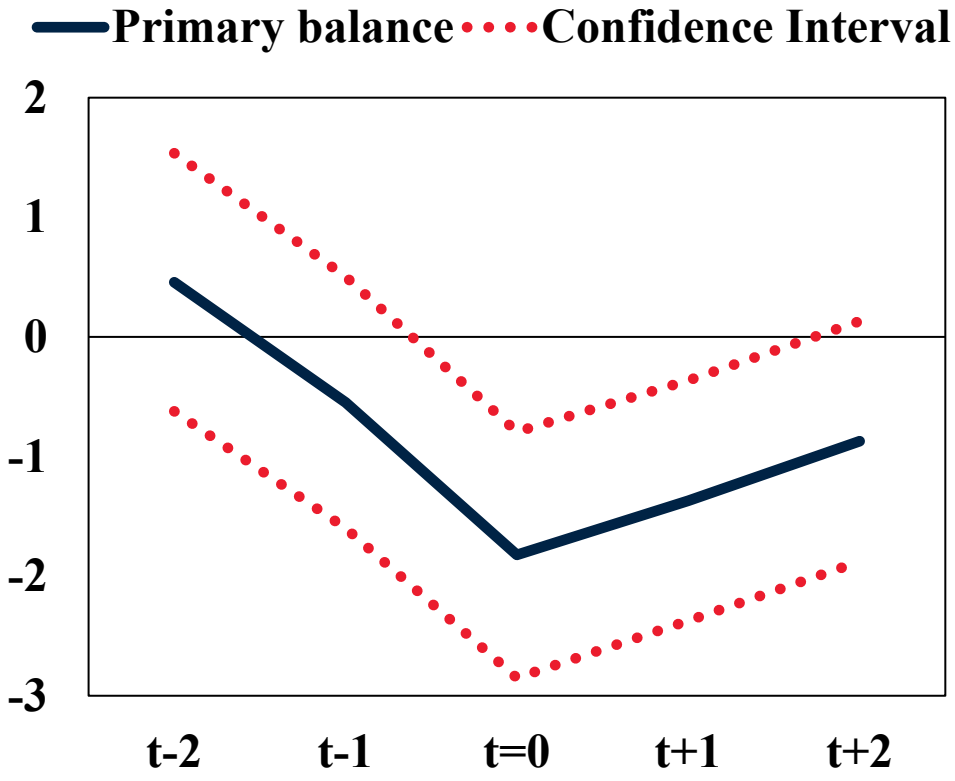
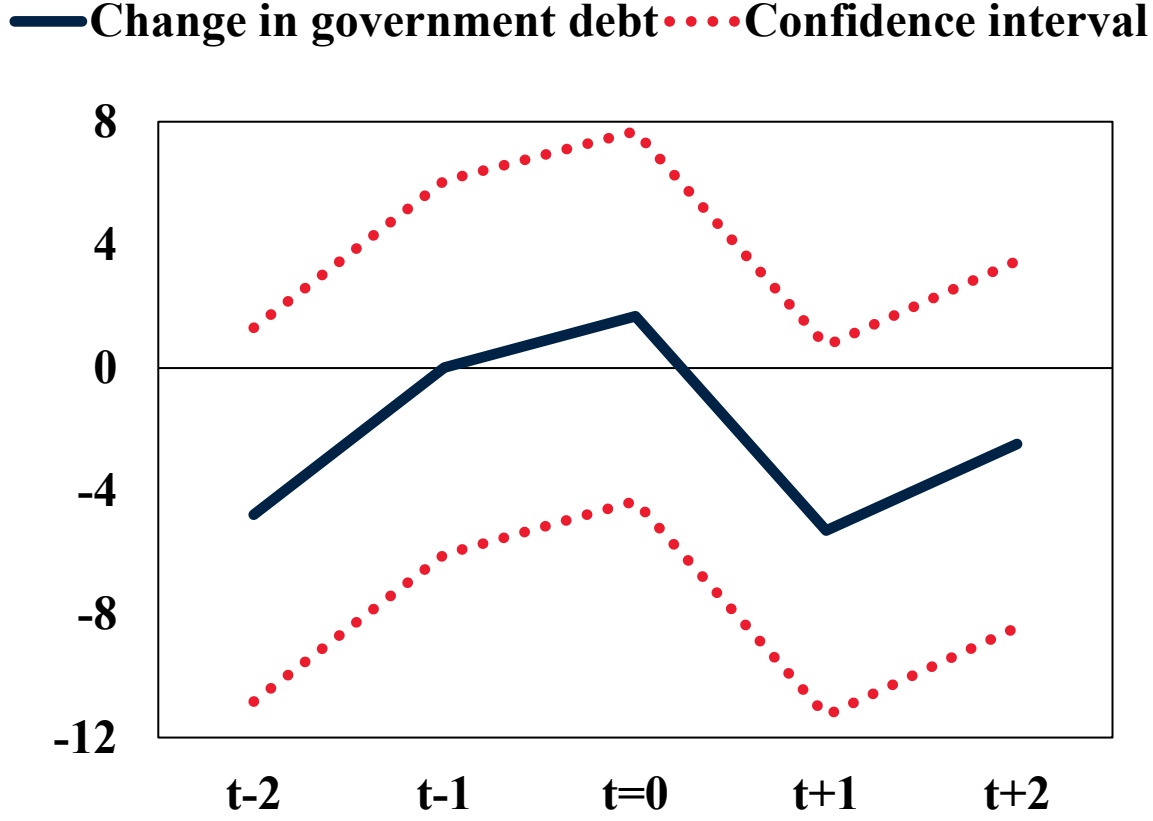
Fiscal outcomes around global recessions

Fiscal Balances Deteriorate Around Global Recessions

Primary balances
(Percent of GDP)



Government debt
(Percent of GDP)



Sources: International Monetary Fund; World Bank.
Note: Years of global recessions (2009 and 2020) are identified in Kose, Sugawara, and Terrones (2020).
Left Panel: Changes in the ratio of fiscal balances around global recessions. Based on 25 LICs. Right Panel: Changes in the ratio of fiscal balances around global recessions. Based on 24 LICs.

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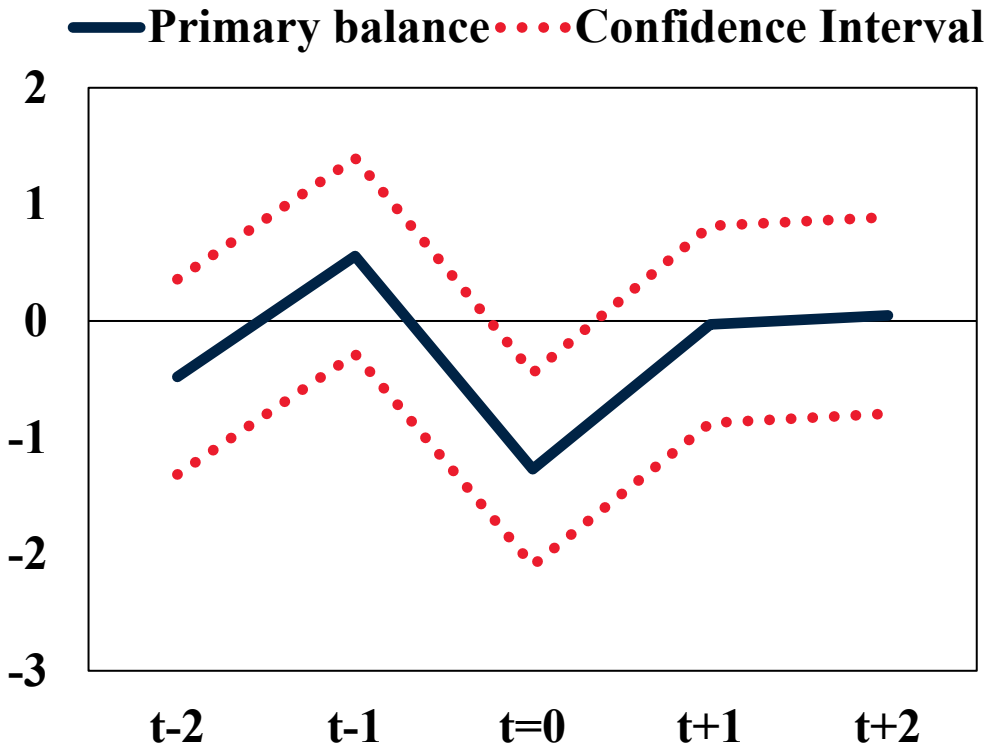
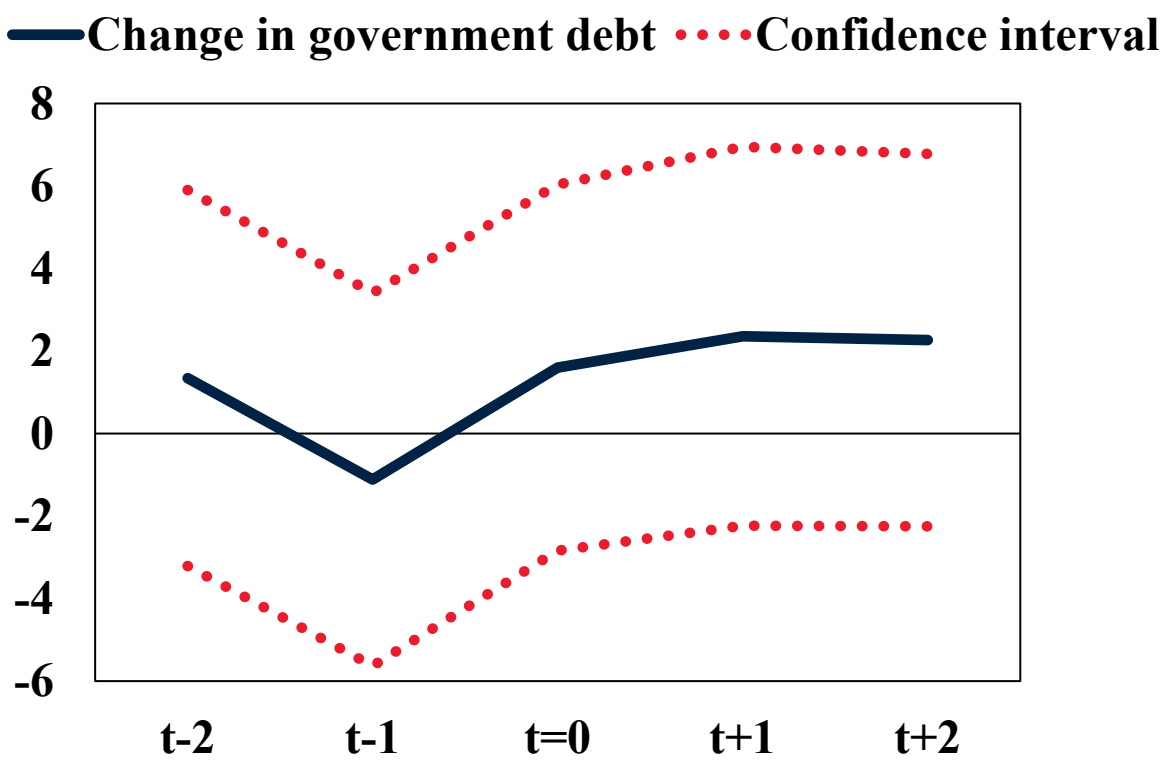
Fiscal Outcomes Around Conflict Events

Fiscal Balances Deteriorate Around Conflict Events

Primary balances
(Percent of GDP)



Government debt
(Percent of GDP)



Sources: International Monetary Fund; UCDP Battle-Related Deaths Dataset (database); World Bank.
Note: The identification of conflict episodes is based on battle-related deaths in the UCDP Battle-Related Deaths Dataset, Version 24.1 (Shawn et al. 2024). The analysis is restricted to episodes with more than one hundred deaths (as best estimates) per one million population. If several conflict events are identified within five years, the one associated with the largest number of deaths per million population is selected as an event.
Left Panel: Changes in ratios of fiscal balances to GDP around conflict events. Based on 25 LICs. Right Panel: Changes in ratios of government debt to GDP around conflict events. Based on 24 LICs

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Four Questions

4 **Which policies can help improve LIC fiscal positions?** *Domestic reforms can support tax policy and tax administration, improve expenditure efficiency, modernize debt management, and spur growth. The international community can complement these reforms with greater financial support and tailored technical assistance to bolster institutional frameworks and to improve fiscal outcomes.*

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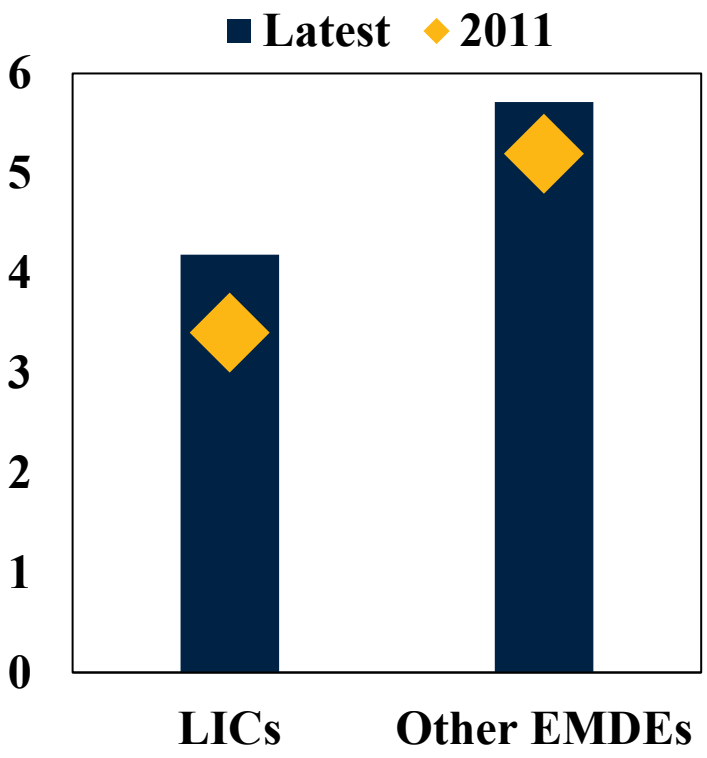
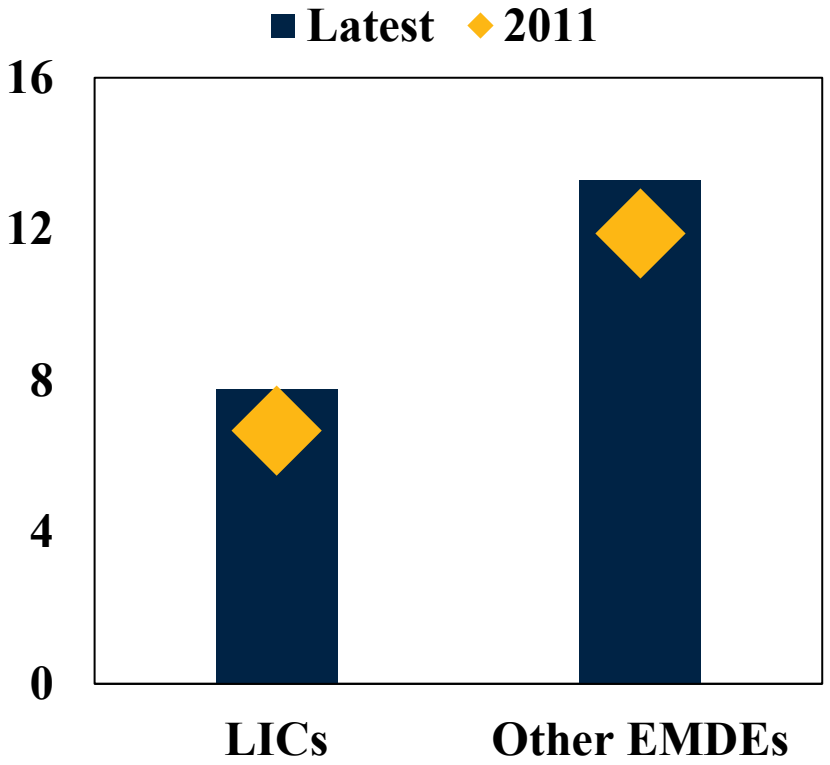
Domestic Revenue Mobilization

Low Tax Effort; Low Tax Efficiency

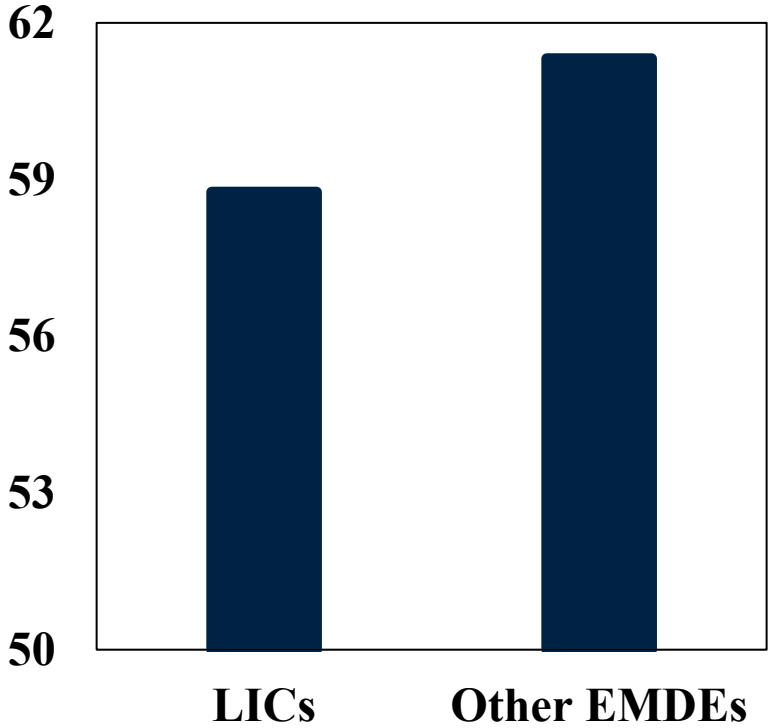
Personal Income Tax Efficiency
(Percent)



Consumption Tax Efficiency
(Percent)



Tax Effort
(Percent)



Sources: International Monetary Fund; McNabb, Danquah, and Tagem (2021); World Bank.
Note: LICs=low-income countries; EMDEs=emerging market and developing economies. Tax efficiency here refers to the share of taxes collected as a share of the overall component. Left Panel: Ratio of personal income tax revenue to total labor compensation. Based on 66 EMDEs (excl. LICs), and 12 LICs. Center Panel: The ratio of consumption tax revenue over consumption. Based on 81 EMDEs (excl. LICs), and 18 LICs. Right Panel: Tax effort measures the extent to which tax collections reach potential (the maximum amount that could be collected based on economic, social, demographic, and institutional conditions), expressed as a percentage. Data are from McNabb, Danquah, and Tagem (2021). Based on 126 EMDEs, of which 19 are LICs.

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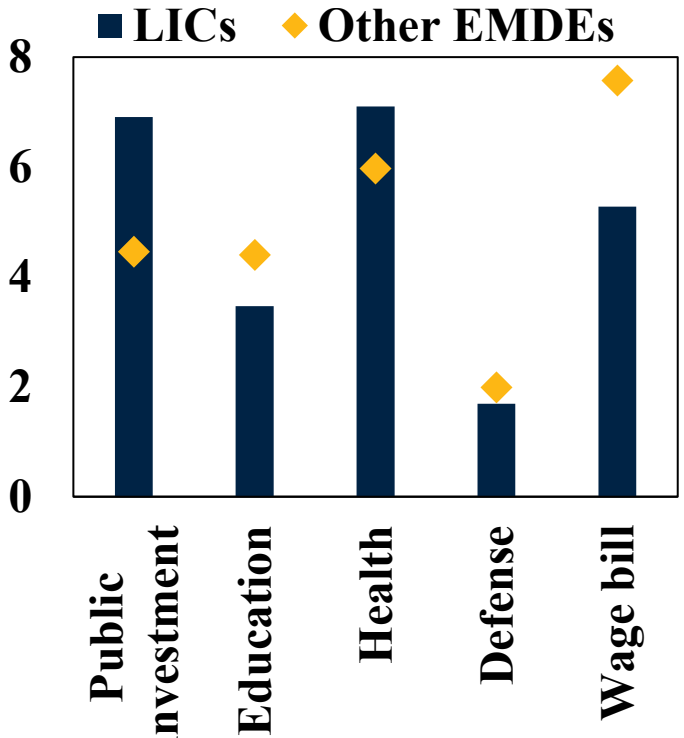
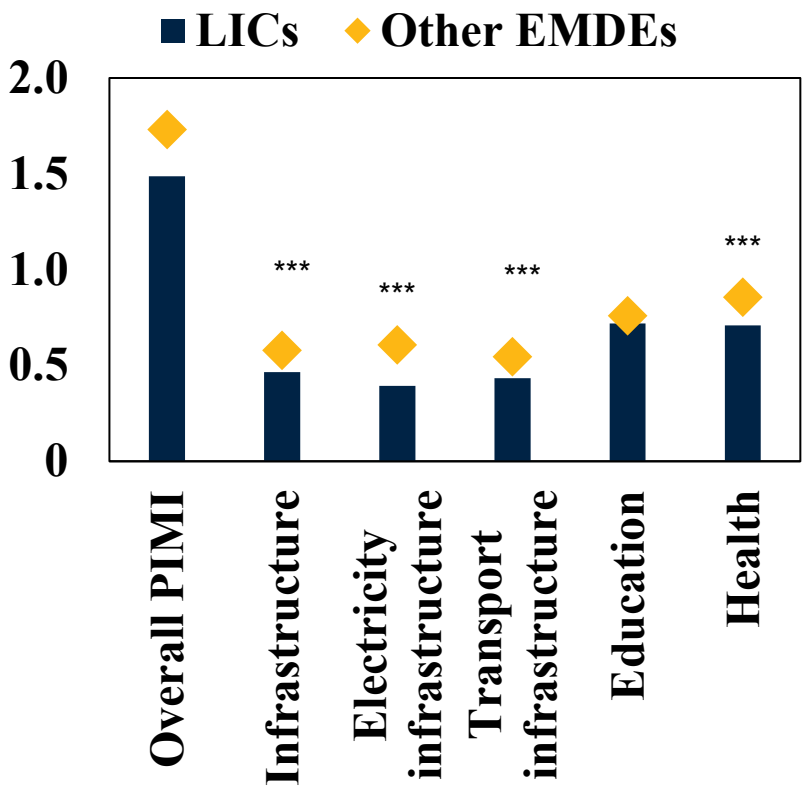
Expenditure Efficiency

Lower Spending Efficiency in LICs Reflects Governance Challenges

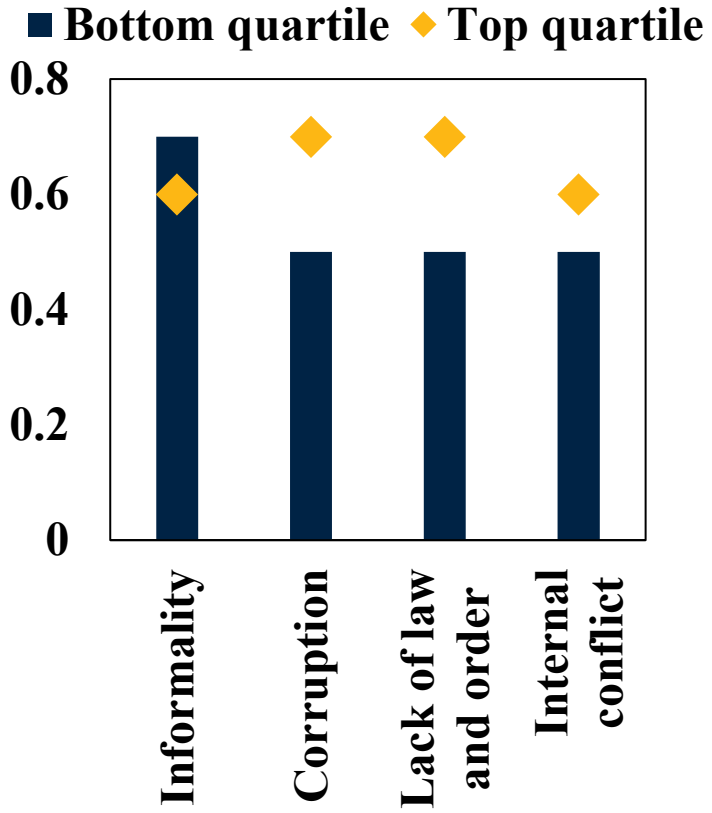
Government spending
(Percent of GDP)



Spending efficiency
(Index)



Factors in efficiency of EMDE infrastructure spending
(Percent)



Sources: Dabla-Norris (2012); International Monetary Fund; World Bank; World Economic Forum

Note: LICs=lower-income countries; EMDEs= emerging market and developing economies. Left Panel: Unweighted averages. Data for up to 26 LICs. Center Panel: Public Investment Management Index. Data for up to 120 EMDEs including up to 21 LICs. Asterisks *** show the significance level at 1 percent, ** at 5 percent, and * at 10 percent. Right Panel: Differences in efficiency of infrastructure spending between top and bottom quartiles of EMDEs. Data for up to 95 EMDEs.

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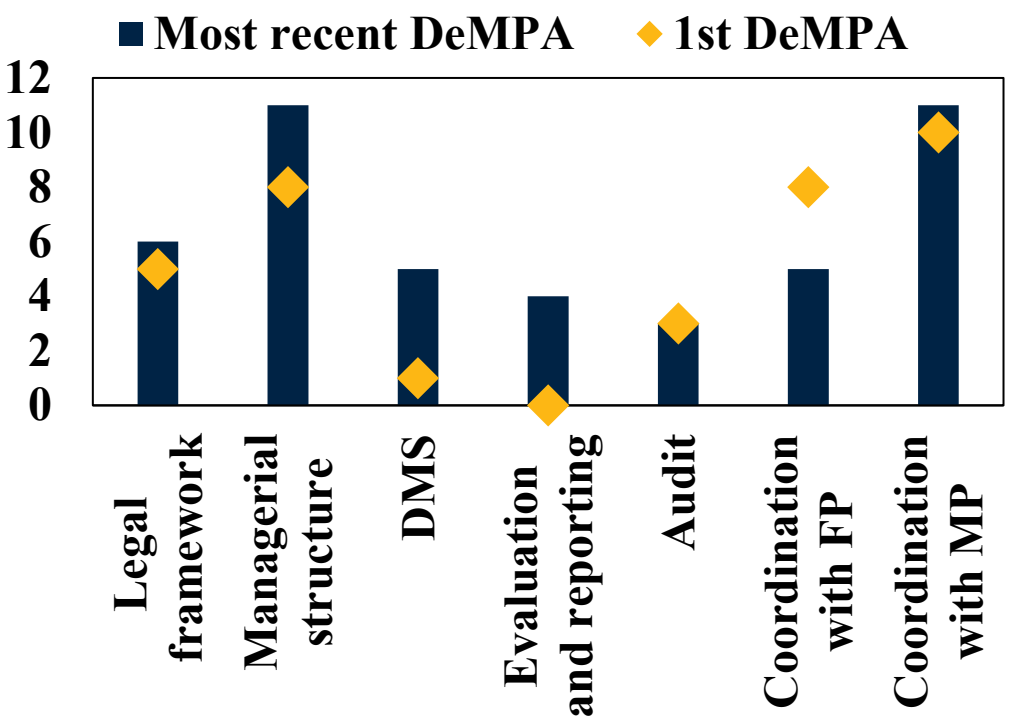
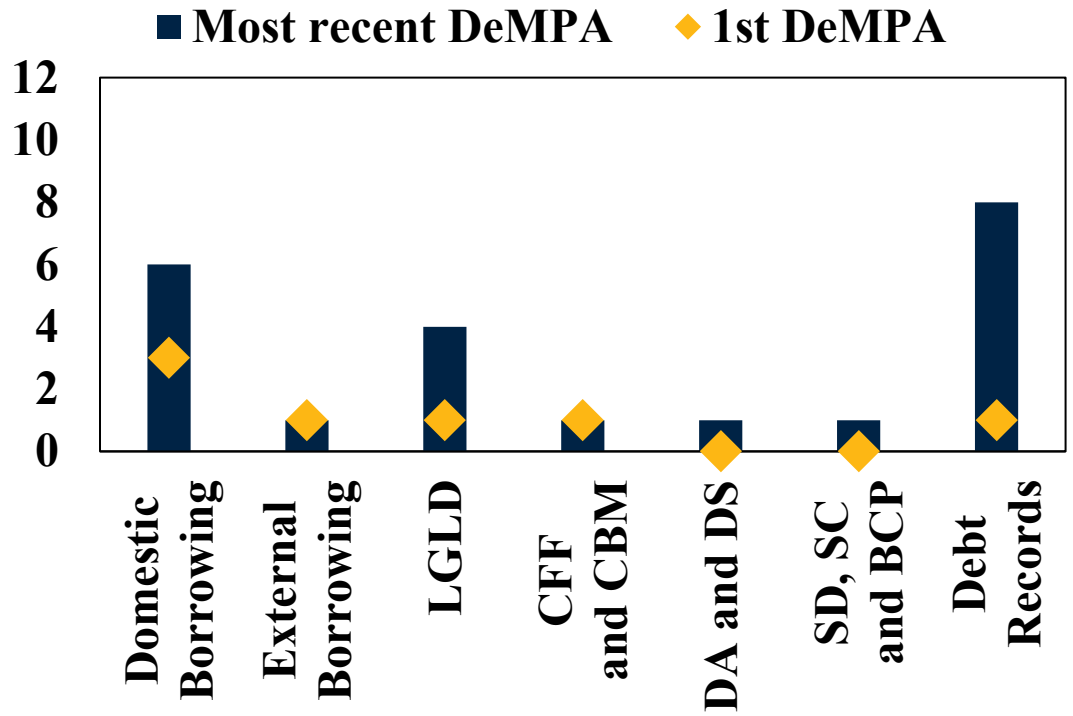
Debt Management and Institutional Quality

Debt transparency weaknesses remain, notably in monitoring and reporting

Countries meeting minimum DeMPA
(Percent)



Countries meeting minimum DeMPA
(Percent)



Sources: Debt Management Assessment Performance; World Bank.
Note: DeMPA = Debt Management Assessment Performance; BCP = business continuity planning; CBM = cash balance management; CFF = cash flow forecasting; DA = debt administration; DMS = debt management strategy; DS = data security; FP = fiscal policy; GLD = loan guarantees, on lending derivatives.

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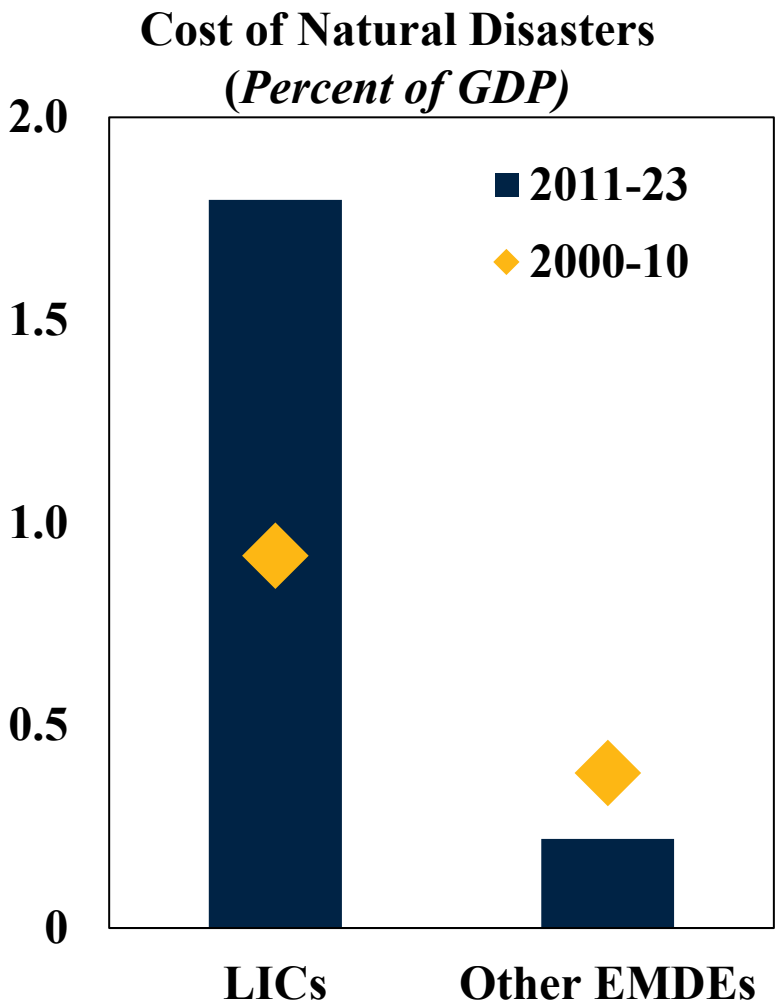
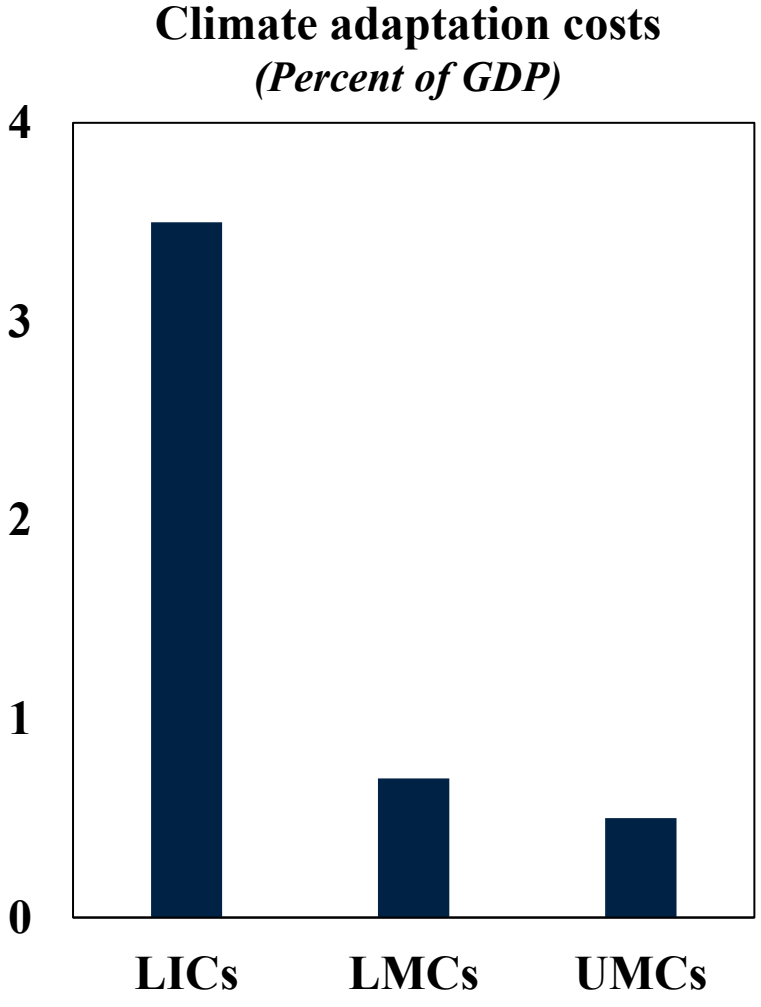
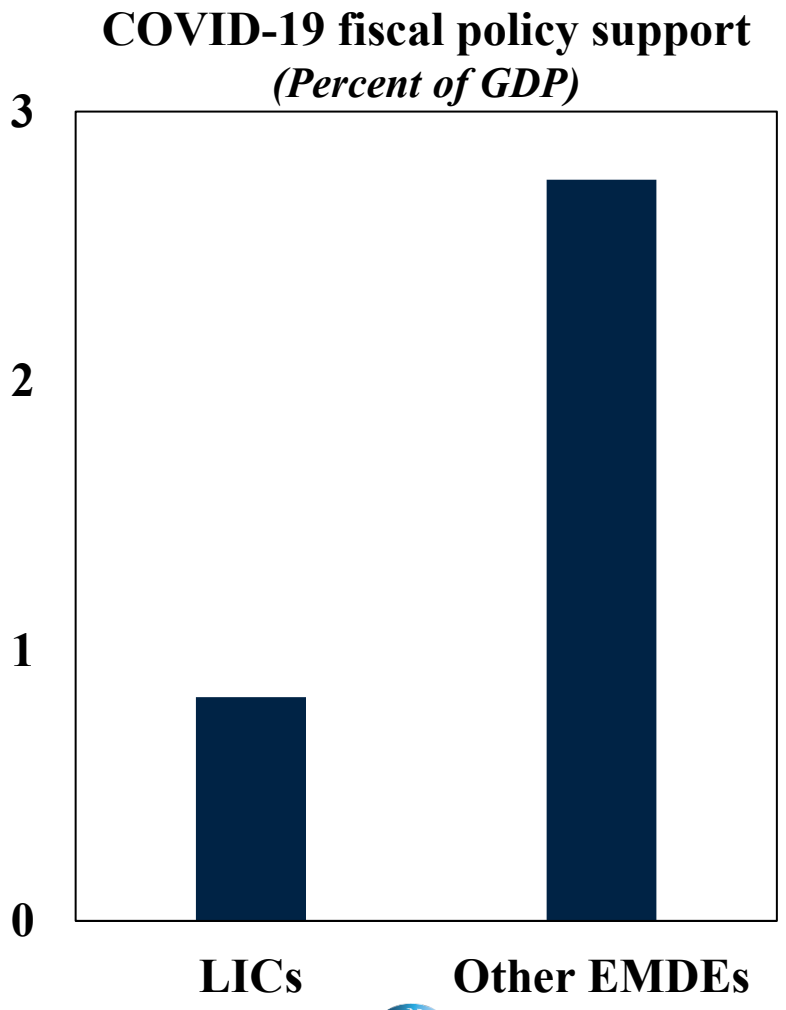
Resilience to Shocks

High vulnerability; Limited Buffers







Sources: EM-DAT (database); United Nations Environment Programme (2023); International Monetary Fund; World Bank.

Note: LICs = low-income countries; LMCs = lower middle-income countries; UMCs = upper middle-income countries; Other EMDEs = non-LIC emerging market and developing economies. Left Panel: Bars and diamonds show the weighted average of economic damages from natural disasters as a percentage of GDP. Based on up to 17 LICs and 105 non-LIC EMDEs. Center Panel: Bars show the modeled estimates of undiscounted annual costs of adaptation for the period up to 2030. Right Panel: Fiscal measures in response to the COVID-19 pandemic as of September 27, 2021. Based on 7 LICs and 69 non-LIC EMDEs.

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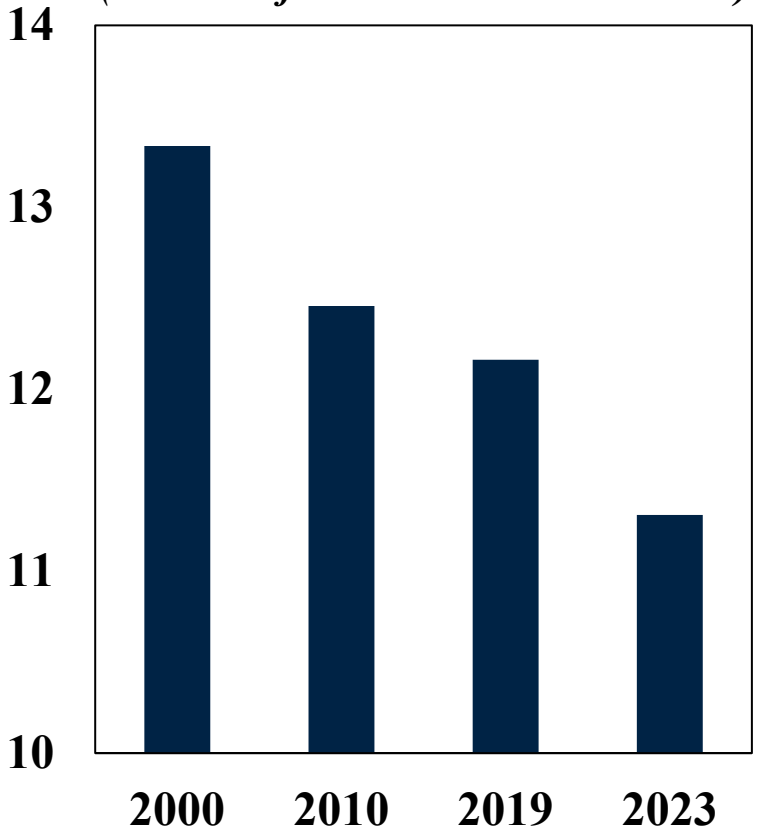
Challenges and Opportunities in Low-Income Countries

Wider Income Gap; Lower Grants Despite Increase by IDA; Potential Demographic Dividend

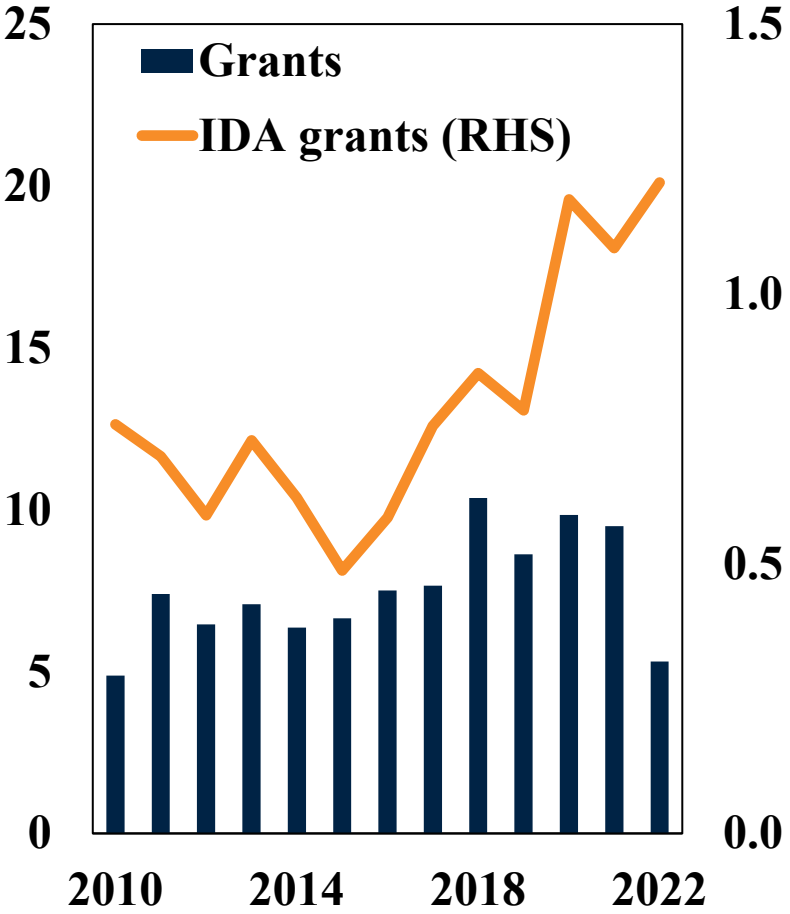
LICs per capita income relative to other EMDEs

(Percent of income in other EMDEs)



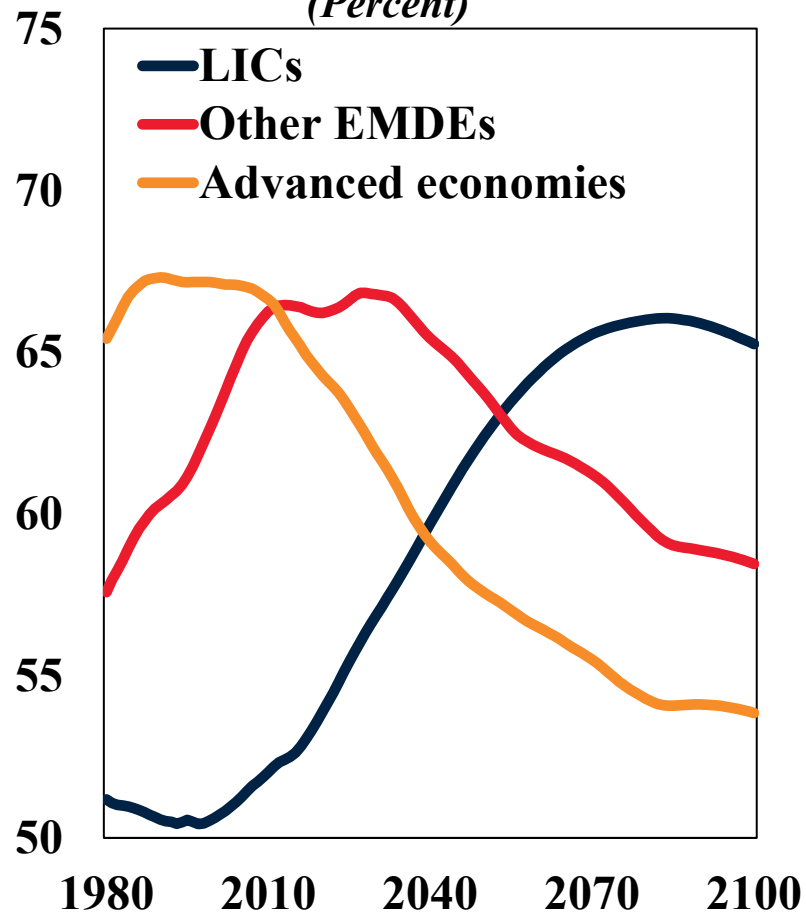
Grants received by LICs

(Percent of GNI)



Working age population

(Percent)



Sources: International Debt Statistics (database); UN World Population Prospects (database); World Bank.

Note: IDA= International Development Association countries. Left Panel: Average real GDP per capita in LICs relative to real GDP per capita of other non-LIC EMDEs. Based on up to 24 LICs and 127 other EMDEs. Center Panel: Data are on a disbursement basis and cover flows from all bilateral and multilateral donors. IDA grants are net disbursements of grants from IDA. . Right Panel: Population-weighted averages. Working-age population is defined as people aged 15-64. Based on 36 AEs, 25 LICs, and 117 other EMDEs.

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Potential of Natural Resources and Demographic Dividends

Rich Endowments Highlight Both Opportunities and Challenges

Natural resources

- Many LICs hold important reserves of minerals critical to the energy transition.
- Natural resources can be a blessing or a curse.
- Robust institutions and well-implemented frameworks are important for harnessing the benefits of natural resources effectively.

Demographics

- LIC working-age populations (as a share of total populations) are rising, against a reversing trend in the rest of the world.
- Healthy, educated and skilled workers can drive growth and enhance prosperity. Conversely, without the right conditions and investment, growing populations can be economically and socially challenging.
- Investment in effective health and education will therefore be crucial for realizing the demographic dividend.

Four Questions

1 **How have fiscal positions evolved in LICs?** *Fiscal positions have deteriorated in LICs, and even more sharply since the pandemic recession.*

2 **What have been the main sources of the recent deterioration in LIC fiscal positions?** *The deterioration reflects expenditure pressures and revenue weakness. External financing, both official development assistance and other flows, have dwindled.*

3 **How do adverse shocks affect fiscal positions in LICs?** *Global recessions and intense conflict events are both associated with weaker primary balances in LICs. The costs of natural disasters and of adapting to climate change are both larger in LICs than in other EMDEs.*

4 **Which policies can help improve LIC fiscal positions?** *Domestic reforms can support tax policy and tax administration, improve expenditure efficiency, modernize debt management, and spur growth. The international community can complement these reforms with greater financial support and tailored technical assistance to bolster institutional frameworks and improve fiscal outcomes.*

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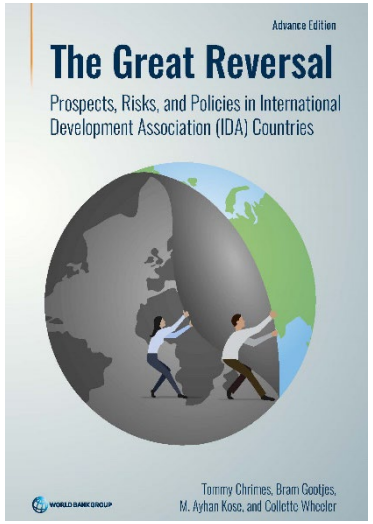
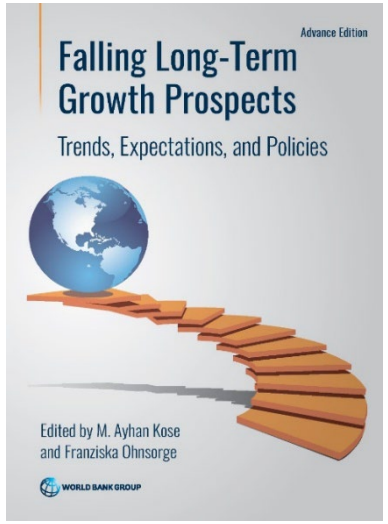
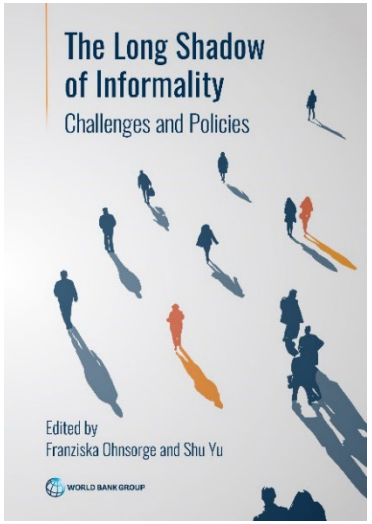
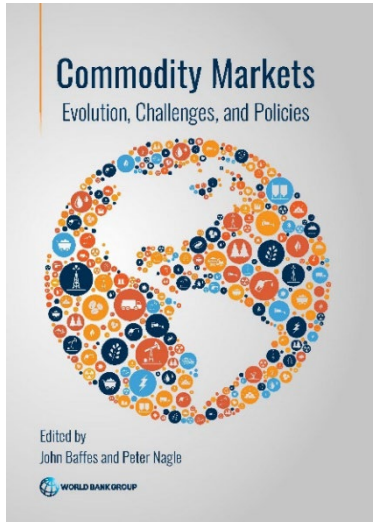
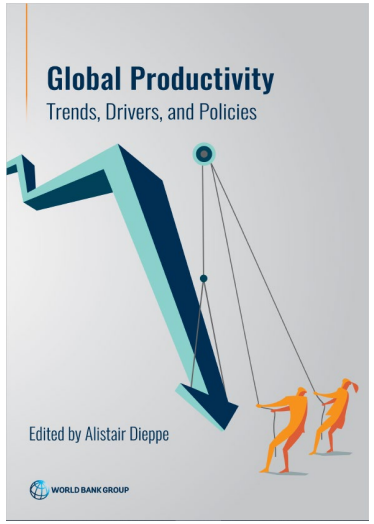
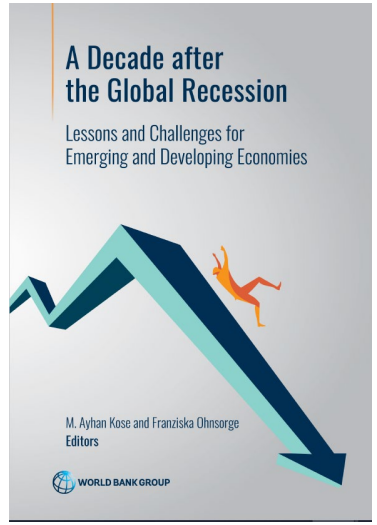
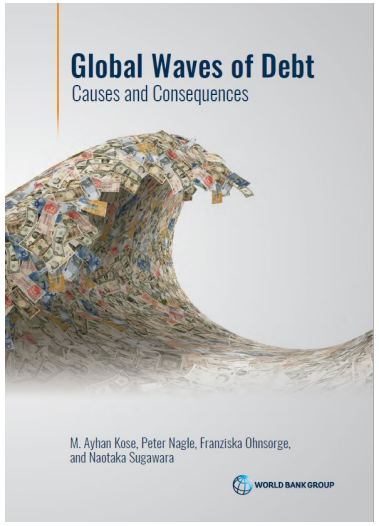
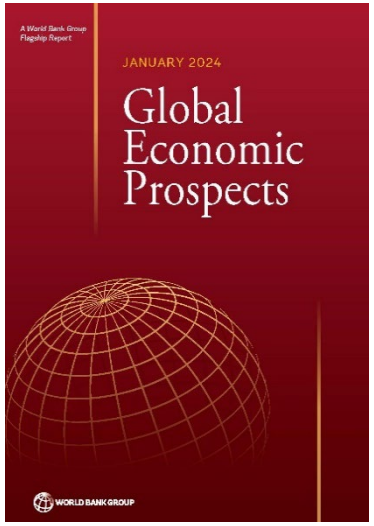
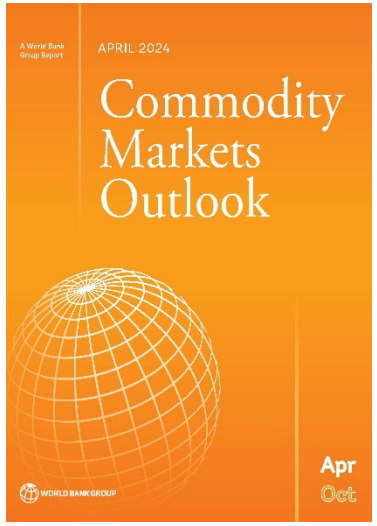
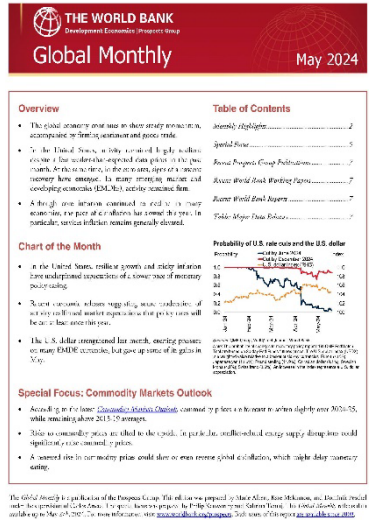
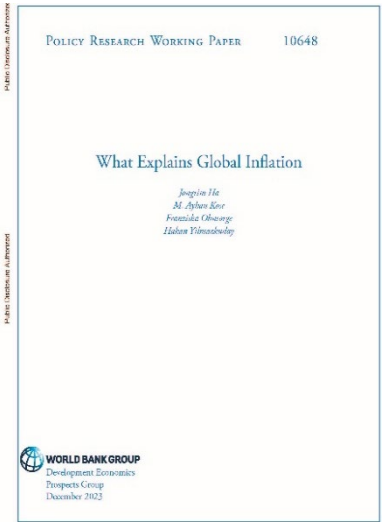
Questions & Comments

Thanks!

- **Fiscal Vulnerabilities in Low-Income Countries**

Studies by the World Bank's Prospects Group