HIGHLIGHTS from Chapter 4:

Fiscal Policy Challenges in Low-Income Countries

Key Points

- *Fiscal positions have deteriorated sharply in Low-Income Countries (LICs) over the past decade. Government debt in the average LIC rose by about 30 percentage points of GDP between 2011 and 2022—almost twice as much as in other emerging market and developing conomies (EMDEs)—to 67 percent of GDP in 2022. As a result, 14 out of the 28 LICs were assessed as being in debt distress or at a high risk of debt distress as of end-April 2023.*
- *The increase in government debt in LICs between 2011 and 2022 reflected persistent revenue weakness and mounting spending pressures that offset the debt-reducing benefits of growth.*
- *A variety of domestic institutional and structural reforms are required, supported by well coordinated global policies, to expand the revenue base, make spending more efficient, and improve debt management practices.*

Development challenges in LICs. LICs are faced with formidable development challenges, which have been compounded by the pandemic, growing climatic vulnerabilities, and the effects of Russia's invasion of Ukraine. About 36 percent of LICs' population lived in extreme poverty in 2019. Food insecurity has intensified and is concentrated in fragile and conflict-affected LICs and those that have faced natural disasters. Adverse shocks such as extreme climate events and conflict are more likely to tip households into distress in LICs than elsewhere because of limited social safety nets.

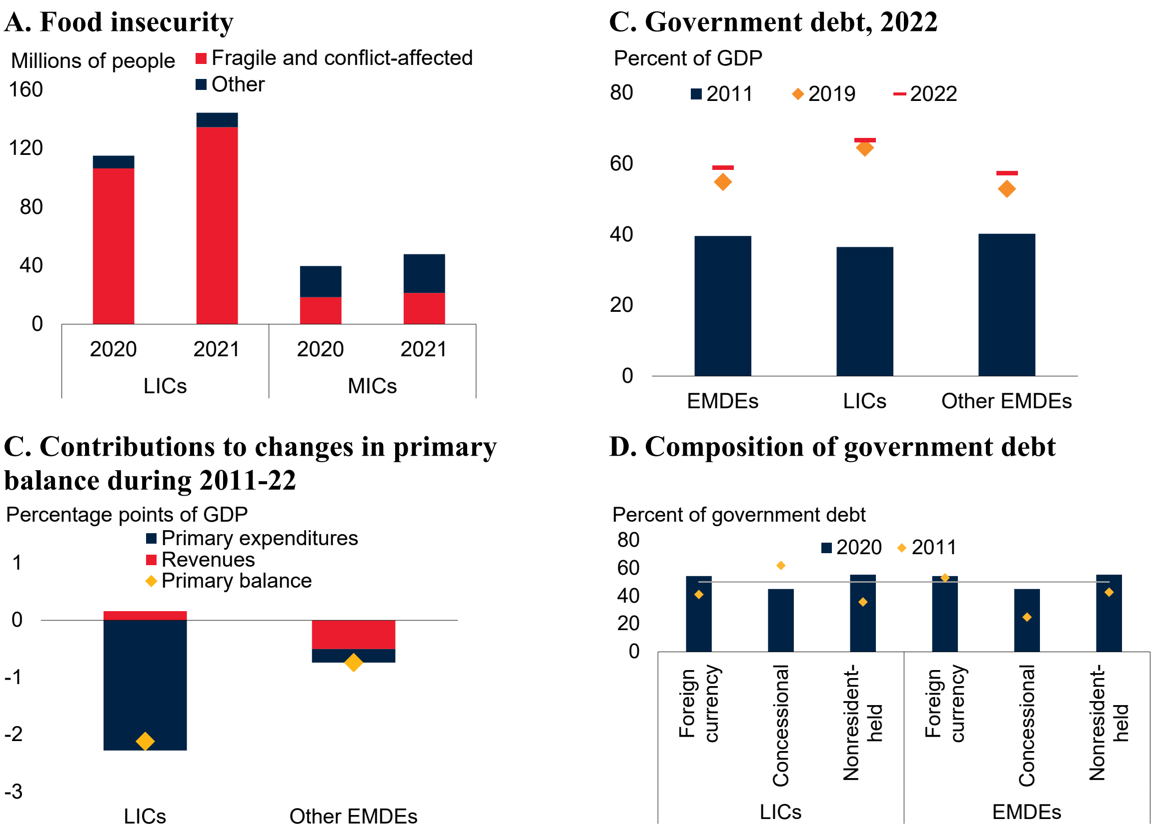
Severely constrained fiscal resources. Between 2011 and 2022, government debt in the average LIC rose by about 30 percentage points of GDP to 67 percent of GDP in 2022—about twice as much as in other EMDEs, where government debt rose to 57 percent of GDP in 2022s. The buildup was widespread among LICs: government debt rose in nine out of ten LICs. The increase in government debt over 2011-22 was largely due to sizable primary deficits that more than offset the debt-reducing effects of growth. In four-fifths of LICs, primary balances deteriorated between 2011 and 2022. In turn, the sizable primary deficits that drove the debt buildup in LICs mostly reflected rapid expenditure growth amid persistent revenue weakness. Total revenues in LICs were 9 percentage points of GDP below those in other EMDEs, on average, over 2011-22. A 4 percentage point of GDP decline in grant financing was only partially offset by rising income (and goods and services) taxes over the decade.

Policy implications. Faced with large development needs, deteriorating fiscal positions, and shrinking grant finance, LICs need to prioritize a combination of policies, including domestic revenue mobilization, improved spending efficiency, and structural interventions to generate stronger growth. High debt levels require strengthened debt management and, in some cases, may warrant debt relief. These measures need to be embedded in domestic reforms to improve institutional frameworks, ease structural constraints, and address informality, and need to be supported by well-coordinated global policies to improve fiscal management, deal with illicit financial flows, and address emerging debt challenges.

Global Economic Prospects

Figure 1. Fiscal policy vulnerabilities in LICs

Food insecurity has intensified and is concentrated in fragile and conflict-affected countries LICs. Between 2011 and 2022, government debt in the average LIC rose by about 30 percentage points of GDP. The sizable and widening primary deficits that drove the debt buildup in LICs mostly reflected rapid expenditure growth amid persistent revenue weakness. LIC debt has also shifted in composition toward external, foreign currency denominated, and non-concessional sources.



Sources: International Monetary Fund; World Bank; World Development Indicators.
Note: Unweighted averages, unless otherwise specified. LICs=low-income countries; EMDEs = emerging market and developing economies.
A. Bars show the number of people in food crisis as classified by the Integrated Food Security Phase Classification (IPC/CH) Phase 3, that is, in acute food insecurity crisis or worse.
C. Bars show unweighted average changes between 2011 and 2022 in revenue-to-GDP ratio and primary-fiscal-balance-to-GDP ratio as well as negative of primary-expenditure-to-GDP ratio.
D. EMDE=emerging market and developing economies. Grey line indicates 50 percent. Latest available data are for 2020.