



The World Bank

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Impact of the Global Financial and Economic Crisis on Fragile and Conflict-Affected Countries

History demonstrates that the poor are at greatest risk from economic “shocks”, whether due to conflict, natural disaster, or economic distress. In the current global downturn, with the impact occurring through different (and often reinforcing) channels, the downside is particularly widespread and serious. Households are pushed into poverty, health conditions deteriorate, school attendance declines, and progress in other critical dimensions of development is stalled or reversed.

Fragile and conflict-affected countries (FCC), most of which are low income countries, can be particularly vulnerable to the adverse impacts of the global financial crisis for two reasons.

- First, many are dependent on commodity exports, remittances, official development assistance (ODA), as well as humanitarian and security-related assistance, all of which have come under intense pressure as a result of the global economic crisis.
- Second, FCC are defined by their weak institutions, ongoing and/or recent conflict, and high poverty levels, which put them in a weak position to cope with the effects of the crisis and to mediate its social impact.

In the absence of appropriate countervailing action, the economic environment in many FCC could further deteriorate, with associated risks of collapse and conflict relapses. The crisis may also move some previously non-fragile countries into the FCC group. The development costs of such outcomes would be large, in both financial and human terms.

Revenues and grants in FCC declined by an average of 4 percent of GDP between 2007 and 2008 (IMF World Economic Outlook, April 2009). This decline in revenue was partially cushioned by rising foreign assistance—total net official development assistance from OECD countries rose by 10.2 percent in real terms in 2008. Nevertheless, large further increases in ODA are unlikely, and revenues and grants in fragile states are expected to decline sharply in 2008-09 from levels reached in 2007.

Impact of the crisis in FCC: Key Issues

- Many FCC rely heavily on revenue from *commodity exports*. Demand for commodities (e.g. oil, cocoa, cotton, aluminum, and other minerals) has diminished significantly since the crisis, and prices have correspondingly declined, putting considerable strain on the public finances of these countries.
- *Remittances* represent a major source of foreign exchange for many FCC and income support for households. As the economies of the countries from which remittances flow decline, the volume of remittances is likely to fall. In Sub-Saharan Africa (SSA), for instance, the World Bank expects remittances to contract by 5-8 percent in 2009.

- Some donors may scale back *ODA* on which FCCs rely for balance of payments and budget support. *Foreign Direct Investment* is also expected to fall, particularly in the natural resource sectors.
- *Poverty*. Globally, the World Bank estimates that the crisis will add 90 million people to the 2010 poverty headcount. In SSA and South Asia, the greatest proportional increase in poverty is expected to occur in fragile and low-growth economies.
- *Fiscal pressure*. The impact of the crisis in FCC will result in a squeeze on foreign reserves, government revenues and lower private capital flows.
- *Debt levels*. Few FCC have completed the HIPC process, with several yet to even reach the decision point and become eligible for interim assistance (e.g., Comoros, Eritrea, Somalia, and Sudan). The crisis may further delay the HIPC process.
- *Stabilization efforts*. The strain on public finances is likely to negatively affect the ability of governments to fund peace-building, state-building and reconstruction, pay civil servants and pursue sound financial policies with their creditors.
- *Risk of conflict relapse*. In FCC, the political and reconciliation processes are fragile in some instances and national capacities to consolidate peace are weak. Lower growth and higher unemployment rates, notably for youth, can have further destabilizing effects and increase the risk of conflict relapses.
- *IDA support* is constrained by the overall envelope and performance-based allocation rules.

Outlook in Sub-Saharan Africa [SSA] with its high concentration of FCC

- **The global recession is estimated to have put at risk core spending of \$11.6 billion (equivalent to about 1.1 percent of GDP) in the poorest countries in 2009** (World Bank staff estimates). Just over two-thirds of this is for countries in Sub-Saharan Africa. Fragile states, including those in SSA and those emerging from conflict, account for 58 percent of the total.

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