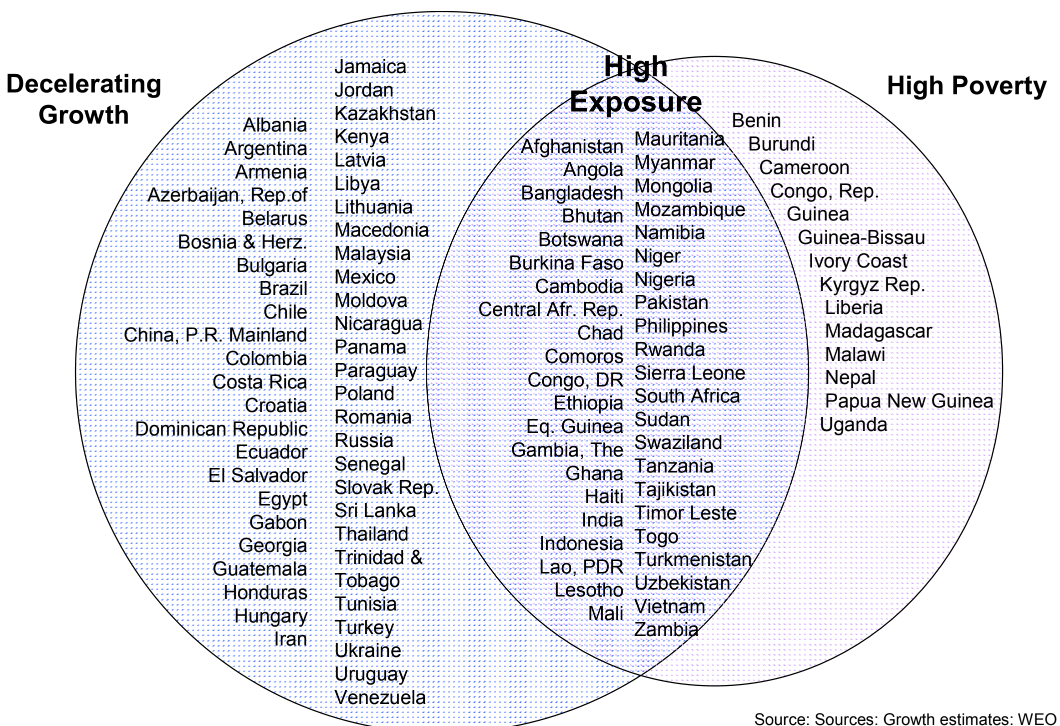
The Global Economic Crisis:
Assessing Vulnerability with a Poverty Lens[1]

Almost all developed and developing countries are suffering from the global economic crisis. While developed countries are experiencing some of the sharpest contractions, households in developing countries are much more vulnerable and likely to experience acute negative consequences in the short- and long-term. Declining growth rates combined with high levels of initial poverty leave many households in developing countries highly exposed to the crisis. Vulnerability is heightened if, at the same time, governments are constrained in cushioning the impacts due limited institutional capacity and fiscal resources. [2]

Main messages:

- *The global economic crisis is exposing households in virtually all developing countries to increased risk of poverty and hardship (figure 1).*[3] Almost 40 percent of developing countries are highly exposed to the poverty effects of the crisis (with both declining growth rates and high poverty levels) and an additional 56 percent of countries are moderately exposed (they face either decelerating growth or high poverty levels), while less than 10 percent face little risk (Annexes 1 and 2).

Figure 1. Exposed Countries



Source: Sources: Growth estimates: WEO January 2009 forecast and Bank staff estimates. Poverty: 2008 WDI estimates for 2005.

[1] This policy note was prepared by Louise Cord, Marijn Verhoeven, Camilla Blomquist and Bob Rijkers, with inputs by Vivek Suri (all PREM) and has been cleared by Danny Leipziger, PREM Vice-President.

[2] Other definitions of vulnerability (e.g., the extent of integration with the global economy) are also relevant in discussing the crisis, but this definition was selected given the focus of this brief on poverty and household vulnerability.

[3] In the short-run, the crisis may aversely affect non-poor households, but over the medium-run, the negative impacts will spread to poor households who are less equipped to handle the crisis.

- *Critical to protecting households in exposed countries will be the ability of governments to cope with the fallout and finance programs that create jobs, ensure the delivery of core services and infrastructure, and provide safety nets.* Yet, only one quarter of the exposed countries have a reasonable fiscal capacity (i.e., the ability to expand fiscal deficits) to undertake significant countercyclical spending. Moreover, one third of these countries with reasonable fiscal capacity is aid dependent and will require external support to finance increased spending. Three quarters of the exposed countries have limited fiscal capacity, and are in urgent need of assistance to protect poor households. Given the limited fiscal space in these countries, the assistance should be provided via grants and low and zero-interest financing to the extent possible.
- *A country's institutional capacity to absorb increased spending will affect the amount and the type of external assistance that is required.* One quarter of exposed developing countries have limited institutional capacity to expand spending for vulnerable groups. In these countries, it will be critical to aim investment support at ensuring continued, and if possible, expanded delivery of core services (health, education, basic public administration) and basic infrastructure, and wherever possible, to reinforce and improve access to safety net programs (public employment, community development fund.
- *The three quarters of exposed developing countries with some or even relatively good institutional capacities have more options for rapidly and effectively absorbing increased spending.* In these countries, governments could benefit from assistance in providing targeted support to exposed groups and regions, as well as support to protect core service delivery and infrastructure maintenance using development policy operations in addition to investment financing.
- *Combining both dimensions of vulnerability, the countries in most critical need of external financial and technical assistance are those with high initial poverty and growth decelerations as well as low fiscal and institutional capacity.*

Annex 1: Methodology

The concept of vulnerability used in the brief is based on an assessment of a country's overall level of exposure and a government's ability to cushion the impact of the crisis on exposed households. This annex explains how these concepts are defined. The analysis is based on cross-country data that imperfectly capture these multi-faceted concepts. Therefore, the classification of countries should be interpreted with caution—it provides a preliminary indication of their vulnerability and how the Bank and the international community might want to prioritize their efforts, but is not a substitute for country-specific assessment of vulnerabilities due to the crisis.

Exposure to the crisis

Countries are considered more exposed where poverty was a large problem before the crisis and where an adverse impact on economic growth is expected.[4]   While in the short-run, the nonpoor may be the most affected by the crisis, experience from past economic and financial crises suggests that the adverse impacts are likely to spread in the medium-term to poor households. Poor household have fewer assets, more limited risk coping mechanisms, and less access to capital markets to help them cope with economic fluctuations. Countries where there is a greater proportion of poor households have a larger share of the population that will be vulnerable to shocks in the medium-term.   Countries are considered "highly exposed" when real per capita economic growth is expected to be lower in 2008–09 compared to the period 2004–07 **and** where 20 percent or more of households were below the $1.25 poverty line in 2005 (Annex 2). Countries are considered to "moderately exposed" when only one of these conditions holds.

Capacity to cope

The capacity of governments to cope with the impacts of the crisis on poverty depends on: (1) fiscal capacity to incur an increased fiscal deficit; and (2) institutional capacity to implement programs aimed at mitigating the poverty impact of the crisis.

Fiscal capacity. Fiscal capacity indicators measure the ability of a country to finance larger fiscal deficits. This is linked to their ability to raise additional funding domestically and from abroad without jeopardizing macroeconomic stability or debt sustainability. Fiscal capacity suggests which countries will face difficulties in increasing expenditures to cope with the crisis.[5] The most vulnerable group is composed of countries with high exposure to the crisis and little or no tolerance for larger fiscal deficits (e.g., Bangladesh, Ethiopia, Haiti, India, Lao, Mozambique and Zambia) (Annex 2).

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[4] Country projections of GDP are from the January update of the IMF's WEO. For Mali, DRC, and Central African Republic, the growth projections are taken from recent country documents (for these countries such documents were issues since December 1, 2008). Poverty is defined using the 2008 WDI poverty supplement with the latest $1.25 a day international poverty line, estimated for 2005. Countries are classified as having high poverty if they are above the median poverty line of 20%.

[5] The fiscal capacity measure averages standardized indexes of in debt/GDP, the fiscal deficit, current account balance, international reserves, and reversible capital inflows using data for 2002–07. Country teams were surveyed about their perceptions of fiscal affordability, and this was used to define threshold values for the indicators to distinguish between cases of 'low', 'medium' and 'high' scope for increasing fiscal deficits. It should be noted that this concept of fiscal affordability focuses on the ability to run larger fiscal deficits—countries may also address tighter fiscal constraints by increasing the efficiency of spending or raising additional revenues (which may be harder to accomplish in the short term). In this sense, fiscal affordability as defined here is narrower than the concept of fiscal space. The measure of capacity is not perfect, and may bias against countries that have large market confidence due to other factors. This has been taken into account in the table in Annex 2—in line with country team perceptions, Brazil was moved from the low to medium fiscal capacity category.

Aid-dependent countries will be particularly constrained. Although they may have low fiscal and external deficits and modest debt, suggesting that they could afford larger fiscal deficits, they may be prevented from doing so because they cannot secure financing in the market. There may be some scope for larger monetization of the deficit, but this is likely to be modest at best (and no such scope exists in high-inflation countries such as Ethiopia). In effect, therefore, their ability to maintain or even increase spending to deal with the social and economic impact of the crisis will depend on the willingness of donors to maintain and enhance financial aid.

Institutional capacity. This dimension of coping capacity assesses a country's capacity to efficiently and effectively scale-up public expenditures, and also evaluates its ability to protect vulnerable groups and reduce poverty. The first component reflects a country's institutional abilities to manage the budget process, design and implement policies, provide services, and deliver accountable and transparent government.[6] The second component measures the institutional capacities of a country to quickly enhance support for poverty reduction programs.[7] It evaluates the consistency of spending with poverty reduction priorities and the quality of social protection policies and programs. Countries with high institutional capacity are well placed to direct additional resources to vulnerable groups to help cushion the impacts of the crisis (e.g., Armenia, Chile, Costa Rica, El Salvador, Malaysia, Mexico, Poland and Uruguay).

It should also be kept in mind that the measure of institutional capacity focuses on the government's ability to mitigate the crisis impact on poverty, and disregards other sources of resilience such as the actions of poor households and CSO initiatives. Finally, governments may be able to formulate measures that are less demanding on their administrative capacity (e.g., some tax measures) but still could prevent a slowdown in economic growth.

[6] This indicator uses CPIA questions 13-16: quality of budget and financial management; efficiency of revenue mobilization, quality of public administration, transparency, accountability and corruption in the public sector.
[7] This indicator uses CPIA questions 10a, d, e on the quality of social protection policies (safety nets/pensions/community development funds) and 8a on the equity of public resource use.

Annex 2: Vulnerable countries:
Exposure (growth impacts and initial poverty levels) and Capacity (Institutional and Fiscal)[1 2]

High Exposure								
Low Fiscal Space			Some Fiscal Space			More Fiscal Space		
1	2	3	4	5	6	7	8	9
Low Capacity	Medium Capacity	High Capacity	Low Capacity	Medium Capacity	High Capacity	Low Capacity	Medium Capacity	High Capacity
• Congo, DR* • Gambia, The* • Lao, PDR* • Tajikistan* • Togo*	• Ethiopia* • Ghana* • India • Mauritania* • Mozambique* • Pakistan	None	• Cambodia* • Central African Rep.* • Comoros* • Haiti*	• Bangladesh • Burkina Faso* • Indonesia • Mali* • Mongolia* • Niger* • Philippines • Rwanda* • Tanzania* • Vietnam* • Zambia*	• South Africa	• Angola • Chad* • Sierra Leone* • Swaziland • Turkmenistan • Uzbekistan	• Bhutan* • Lesotho* • Nigeria*	▪ Botswana
Medium Exposure								
Low Fiscal Space			Some Fiscal Space			More Fiscal Space		
Low Capacity	Medium Capacity	High Capacity	Low Capacity	Medium Capacity	High Capacity	Low Capacity	Medium Capacity	High Capacity
▪ Burundi* ▪ Guinea* ▪ Guinea-Bissau* ▪ Ivory Coast ▪ Liberia*	▪ Albania* ▪ Argentina ▪ Egypt ▪ Jamaica ▪ Jordan* ▪ Kyrgyz Rep.* ▪ Madagascar* ▪ Malawi* ▪ Nicaragua* ▪ Panama ▪ Senegal* ▪ Sri Lanka ▪ Turkey	▪ Croatia ▪ Georgia* ▪ Latvia ▪ Poland ▪ Uruguay	▪ Belarus	▪ Benin* ▪ Bosnia & Herz.* ▪ Brazil ▪ Colombia ▪ Dominican Republic ▪ Guatemala ▪ Honduras* ▪ Kazakhstan ▪ Kenya* ▪ Moldova* ▪ Nepal* ▪ Tunisia ▪ Uganda* ▪ Ukraine	▪ Armenia* ▪ Bulgaria ▪ Costa Rica ▪ El Salvador ▪ Macedonia, FYR* ▪ Mexico ▪ Romania	▪ Congo, Republic of* ▪ Ecuador ▪ Gabon ▪ Papua New Guinea* ▪ Paraguay ▪ Venezuela, Rep. Bol.	▪ Azerbaijan, Rep. ▪ Cameroon* ▪ China P.R.: Mainland ▪ Iran, I.R. of ▪ Russia	▪ Chile ▪ Malaysia ▪ Thailand

Low Exposure								
Low Fiscal Space			Some Fiscal Space			More Fiscal Space		
1	2	3	4	5	6	7	8	9
Low Capacity	**Medium Capacity**	**High Capacity**	**Low Capacity**	**Medium Capacity**	**High Capacity**	**Low Capacity**	**Medium Capacity**	**High Capacity**
▪ Djibouti*	None	None	None	▪ Morocco ▪ Yemen, Republic of	None	▪ Algeria	▪ Bolivia*	▪ Peru

[1] The following World Bank client countries are excluded from the table, either because of data unavailability or because they are categorized as very small economies with a population of less than 0.5 million: Antigua and Barbuda, Afghanistan, The Bahamas, Belize, Brunei, Cape Verde, Cook Islands, Dominica, Fiji, Grenada, Guyana, Hungary, Iraq, Kiribati, Korea, Lebanon, Lithuania, Maldives, Marshall Islands, Mauritius, Federal States of Micronesia, Montenegro, Myanmar, Namibia, Nauru, Samoa, São Tomé and Príncipe, Serbia,, Seychelles, Slovak Republic, Solomon Islands, Somalia, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines., Sudan, Suriname, Timor Leste, Tonga, Tuvalu, Vanuatu, Zimbabwe.

[2] Countries with "more fiscal space" in Annex 2 are able to expand their fiscal deficits, while countries with "some" or "low" fiscal space have limited capacity to undertake significant countercyclical spending. Countries with "low capacity" have an average CPIA score below 3 for CPIA questions 13-16, 10a, d, e and 8a, while "high capacity" countries score 4 or higher.