Media Briefing on Launching of the

UNCTAD's LDCs REPORT 2019

The present and future of external development finance – old dependence, new challenges

Towfiqul Islam Khan

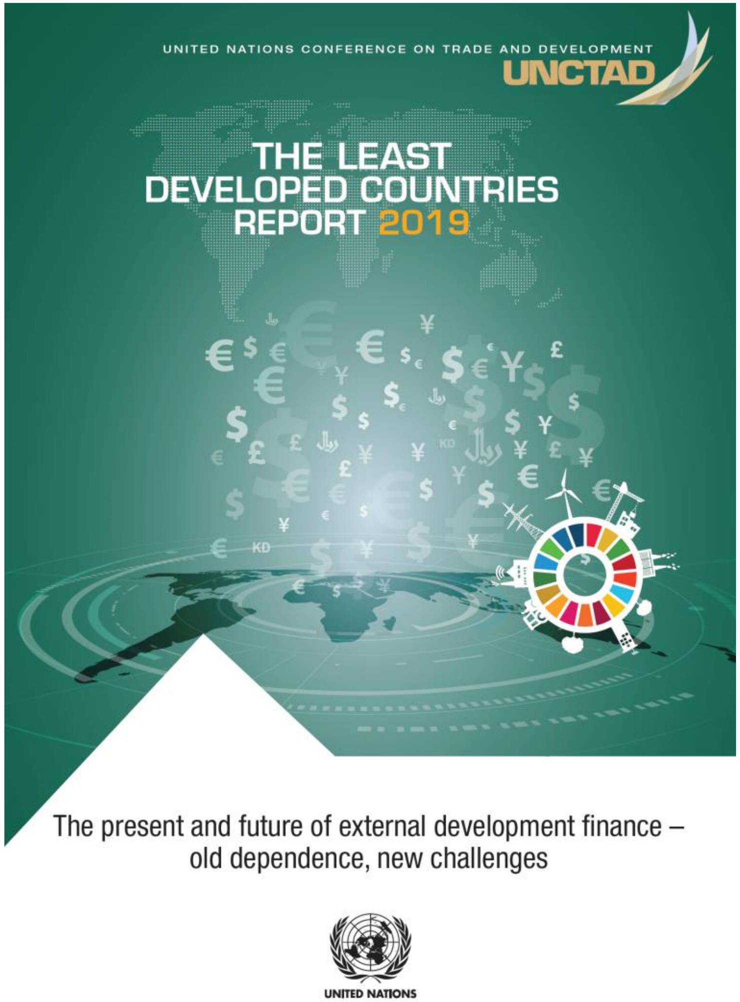
Senior Research Fellow, CPD

Dhaka: 20 November 2019

Organised by

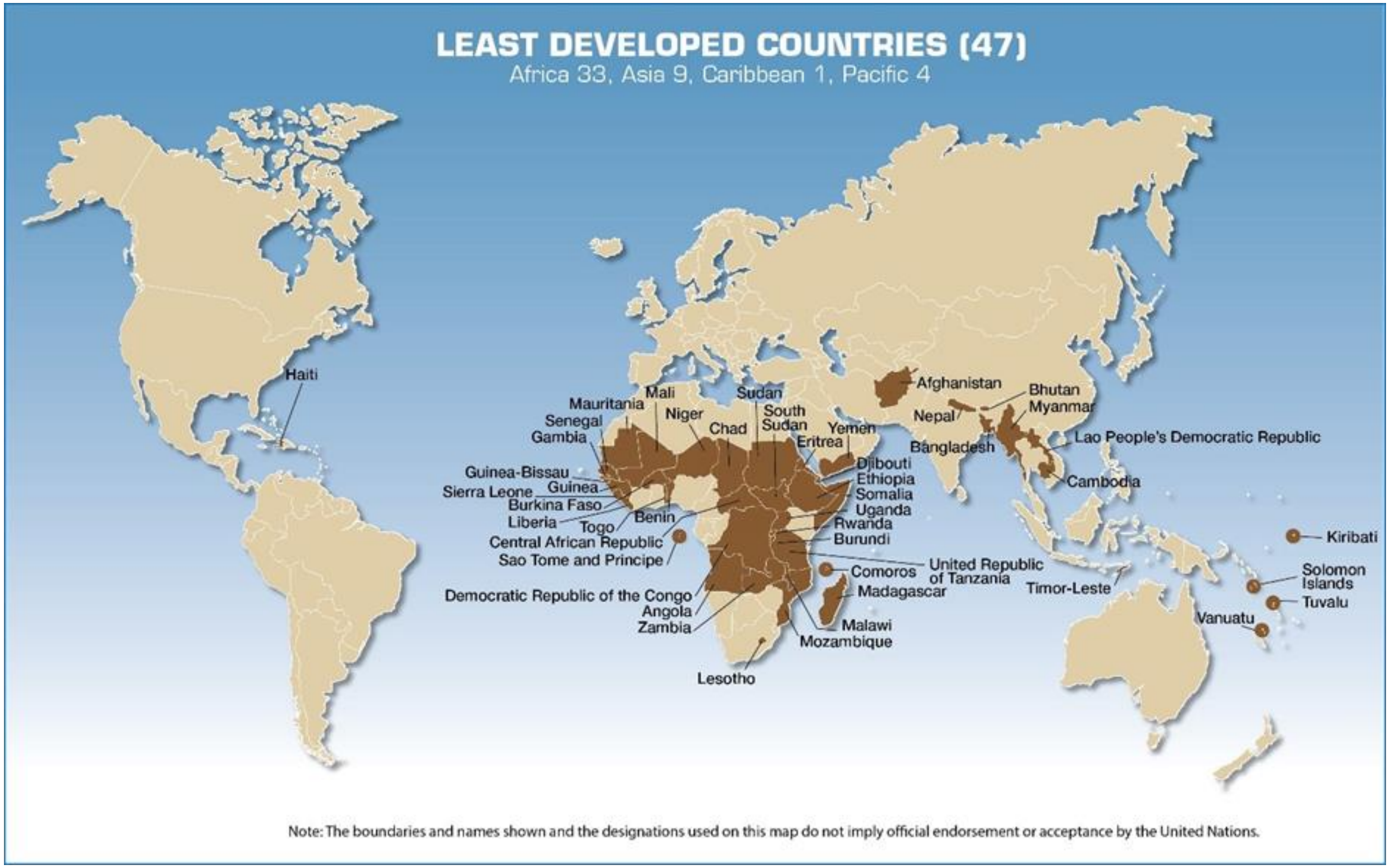
CENTRE FOR POLICY DIALOGUE

Outline



- Information on LDCs
- Structural transformation and financing for development
- The evolving terms of aid dependence
- Private development cooperation: More bang for the buck?
- External development finance and fiscal space
- The Bangladesh context
- Policy options

Information on LDCs



Current Composition

- 25 LDCs in 1971
- 47 LDCs in 2019
- 17 landlocked
  9 small islands
- 33 African
  9 Asian
  4 Pacific
  1 Caribbean

Information on LDCs

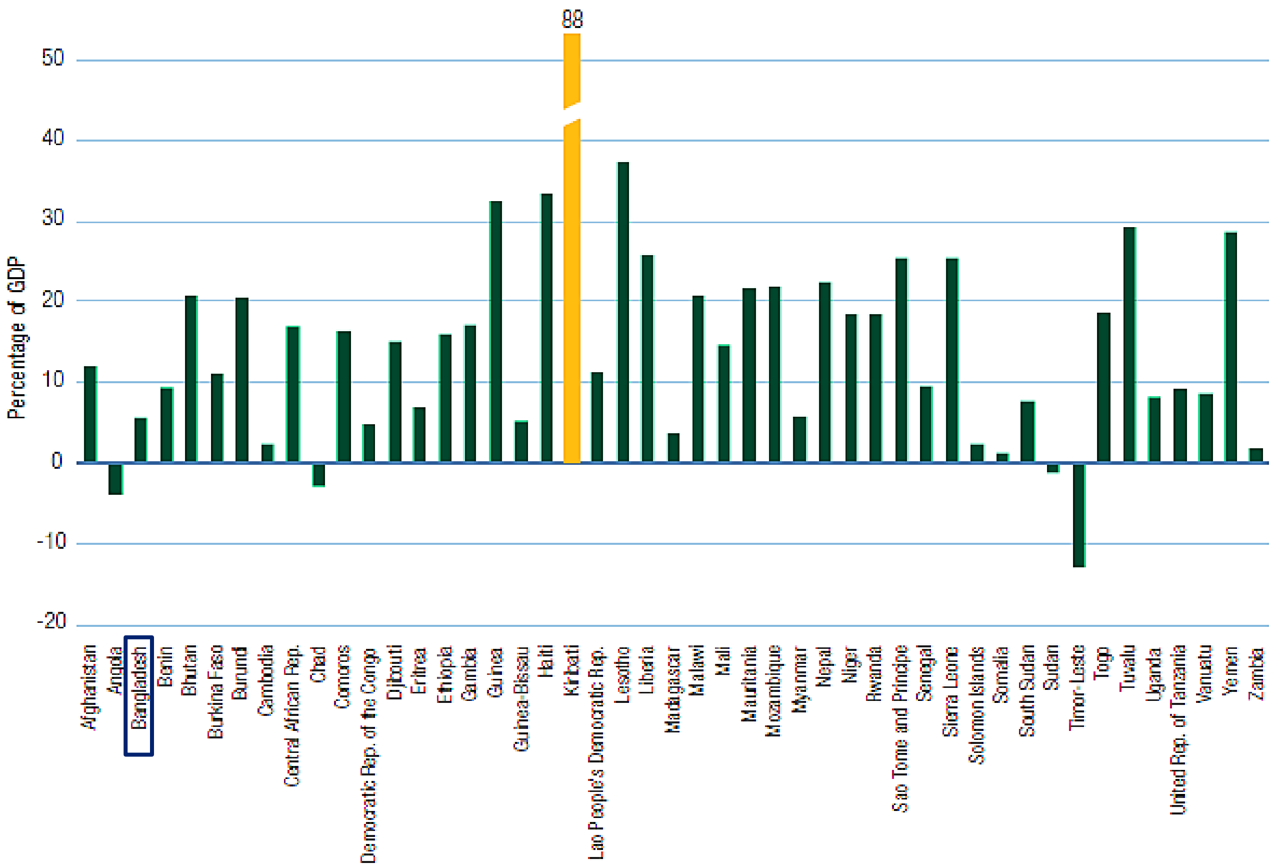
- **5 countries** have graduated from LDC status : **Botswana** in December 1994, **Cabo Verde** in December 2007, **Maldives** in January 2011, **Samoa** in January 2014 and **Equatorial Guinea** in June 2017
- **6 countries** are expected to graduate in next couple of years
  - **Vanuatu** in **December 2020**
  - **Angola** in **February 2021**
  - **Tuvalu** and **Kiribati** in **"no later than" 2021**
  - **Nepal** and **Timor-Leste** were found technically eligible but decisions deferred till 2021 in view of these two States' plea
- **6 countries** are in the pipeline
  - **Bhutan (2023), Sao Tome and Principe (2024)** and **Solomon Islands (2024)** were recommended in 2018 review
  - **3 Asian countries** were found pre-eligible
    - **Lao People's Democratic Republic** (income and human assets)
    - **Bangladesh** and **Myanmar** (income, human assets and economic vulnerability)

Structural transformation and financing for development

- The critical condition for the LDCs to achieve the Sustainable Development Goals (SDGs) is that their economies undergo structural transformation
- SDGs add to the long-standing external financing needs of LDCs
- The challenge for developing countries is to finance investment and technological upgrades for structural transformation, while maintaining a sustainable balance of payment outcome
- The persistent shortfall in domestic savings makes LDCs heavily dependent on external development finance, especially official development assistance (ODA)
- LDCs are dependent on significant amounts of external finance
- In 2015–2017, the resource gap (defined as the difference between domestic savings and gross fixed capital formation) in LDCs, as a group, averaged 8 percentage points of GDP

Structural transformation and financing for development

Resource gap in the least developed countries, 2015–2017



- For nearly half of LDCs, the resource gap remained above 15 percentage points of GDP, which is particularly high for small economics and island LDCs
- Bangladesh's resource gap was lower than LDC average

Economic Performance, Structural Transformation, Resources and Current Account Deficits

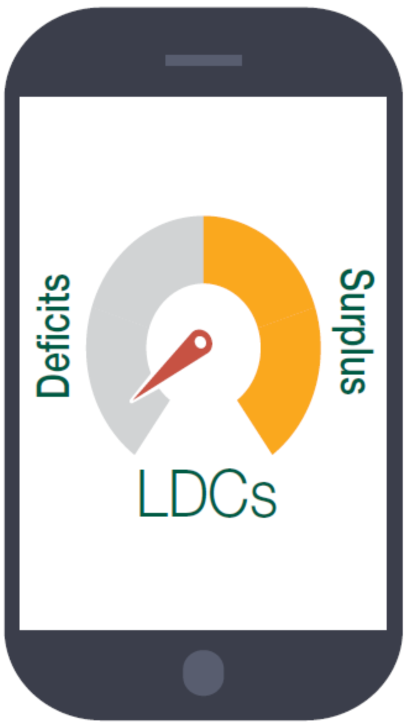
- The uneven global recovery, coupled with weak commodity prices for most of the past decade, have certainly taken a toll compared to the pre-crisis period
- Only seven LDCs (Bangladesh, Burkina Faso, Cambodia, Ethiopia, Rwanda, Senegal and South Sudan) are meeting the 7% growth target, roughly half of those at the beginning of the 2000s, while the number of LDCs experiencing a contraction of real GDP per capita is only marginally lower than the peak in 2015-2016
- On the demand side, LDCs have achieved relatively high investment ratios (at least since the mid-2000s) but consumption absorbs, on average, 80% of GDP
- LDCs have therefore traditionally depended on foreign savings to finance the bulk of their capital accumulation

Economic structure and trade performance

- At an equally fundamental level, the expansion of trade flows has largely failed to support a rebalancing of LDC specialization patterns, in particular of the heightened reliance on primary commodities exports and on imported manufactures and capital goods
- Of 46 LDCs for which data are available, UNCTAD classifies 39 as commodity dependent, with Bangladesh, Bhutan, Cambodia, Haiti, Nepal and Tuvalu the only exceptions

Structural transformation and financing for development

50% of LDCs recorded **no current account surplus** between **2002** and **2017**



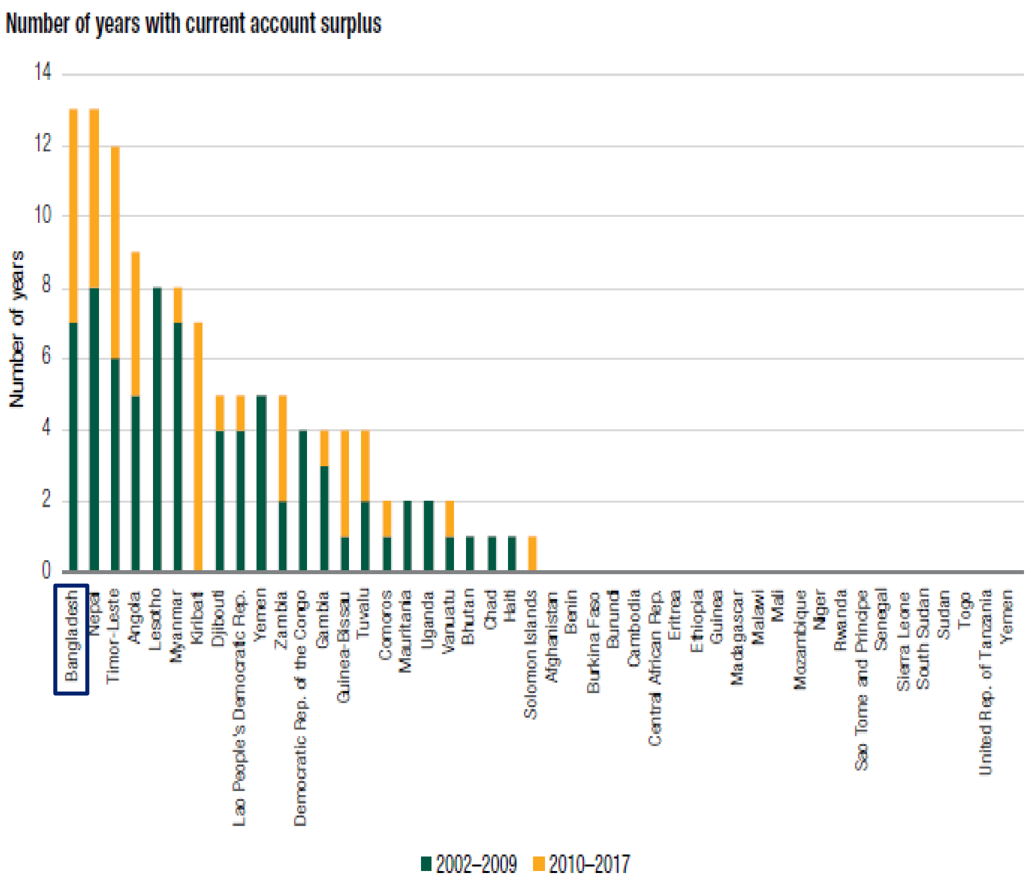
Other LDCs registered mainly **sporadic surpluses**

⇒

Dependence on **external resources** for **capital accumulation**

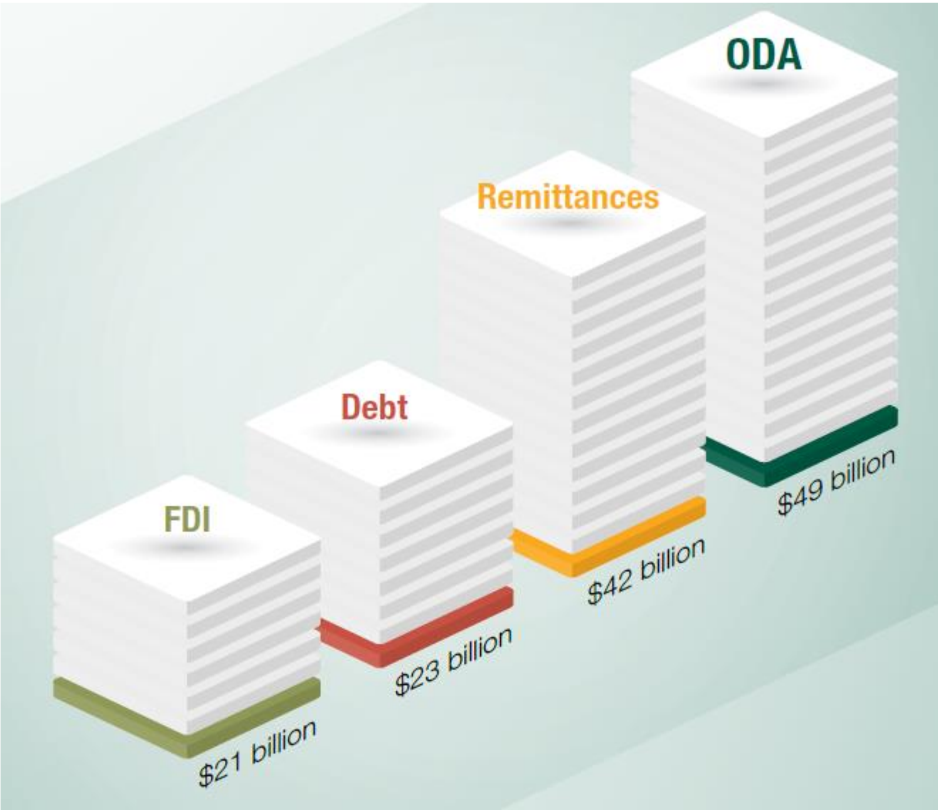
43 LDCs, dependent

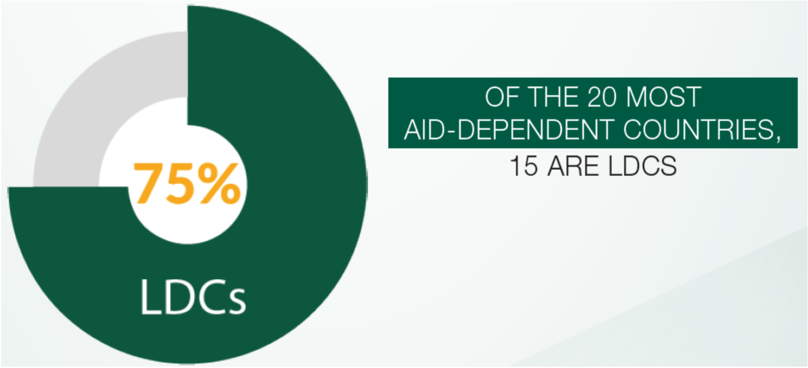
Structural transformation and financing for development



- LDCs recording a frequent current account surplus include large recipients of workers' remittances (such as Bangladesh, Lesotho and Nepal)
- Structural current account deficits have been the rule among LDCs, with fuel and mineral exporters or countries receiving transfers and income payments as the main exceptions, as the last 16 years confirm

Structural transformation and financing for development

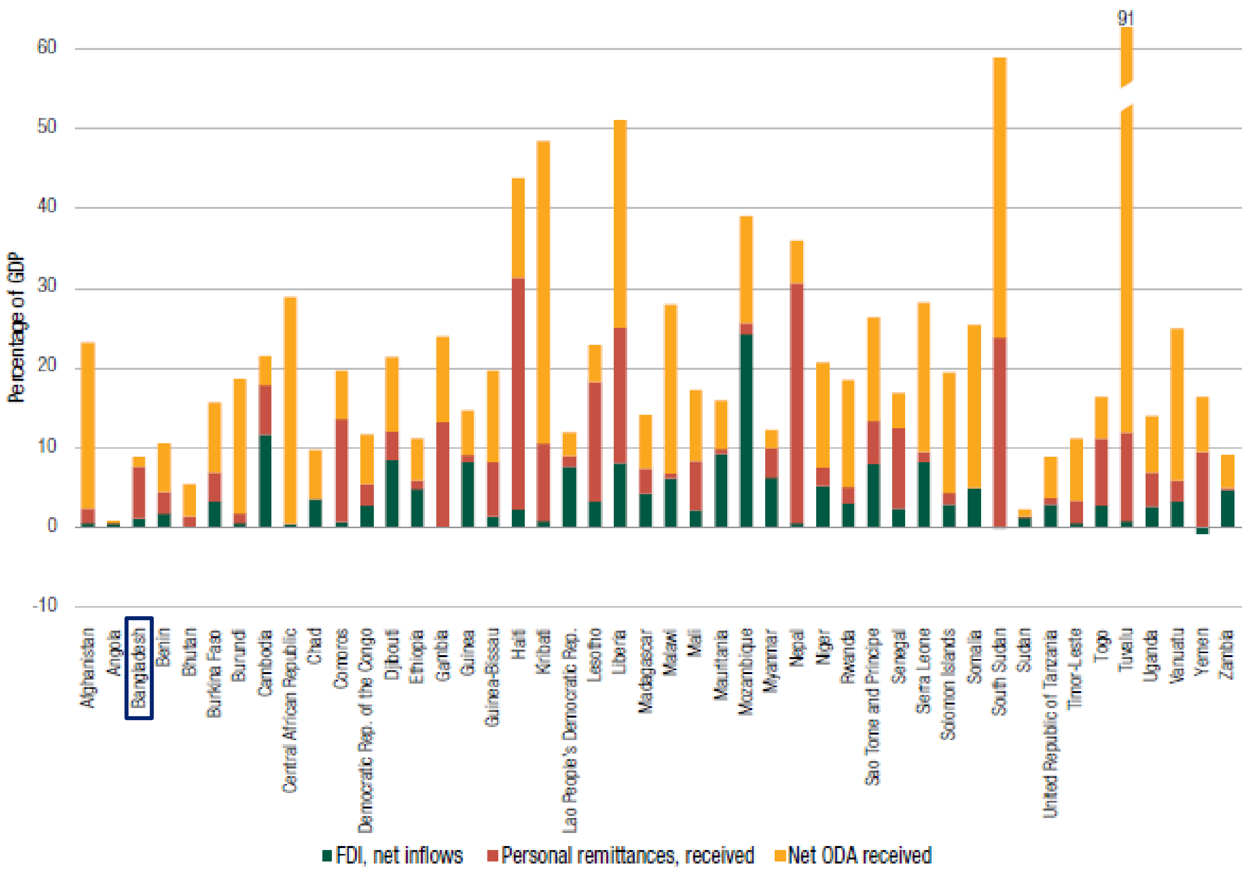




Structural transformation and financing for development

Evolution of LDC Dependence on External Finance

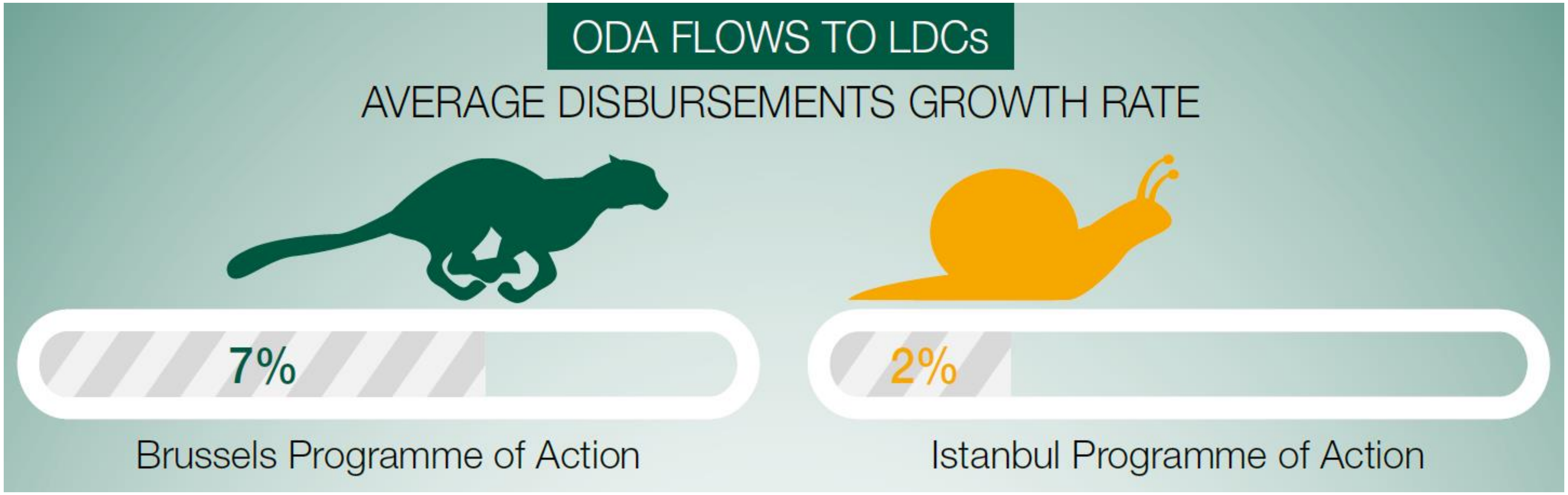
Main flows of external financing to the least developed countries (2015–2017)



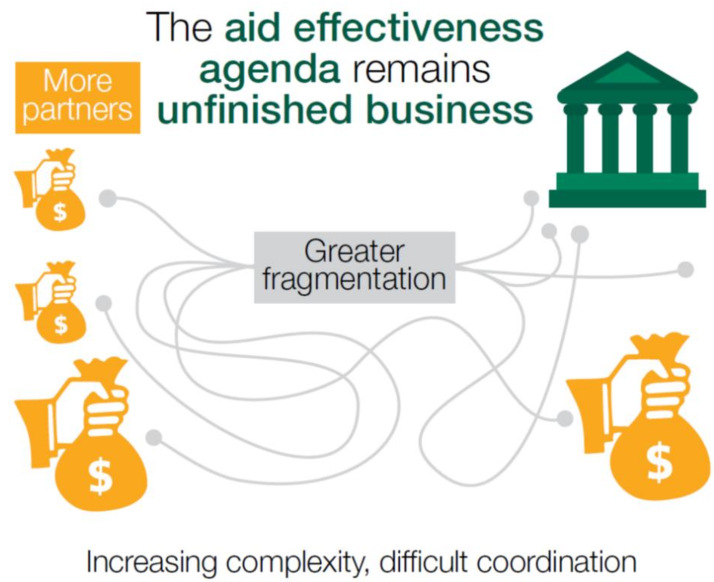
- Personal remittances, received accounts for the largest share among Bangladesh's main flow of external financing whereas FDI, net inflows and Net ODA received account for smaller shares
- The net amount does not exceed 10% of the total GDP

The evolving terms of Aid Dependence

- The origin of the LDC-specific target for aid allocation dates back to the Substantial New Programme of Action for LDCs of 1981 when donor countries committed to provide ODA equivalent to 0.15–0.20% of their own GNI
- This was reaffirmed in subsequent Programmes of Action, as well as in the MDGs and SDGs (17.2)
- However, disbursements fall short of this target (0.09% of GNI)



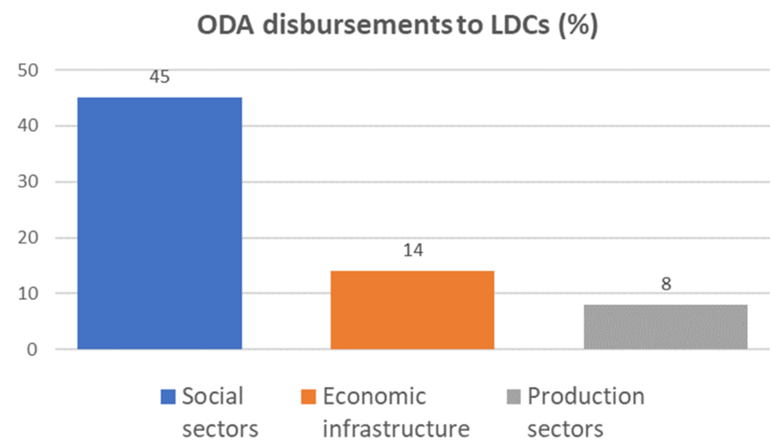
The evolving terms of Aid Dependence



- The new aid architecture bears more partners, a wider array of instruments and modalities. This has created more fragmentation and has increased the need for better aid coordination. It also highlights the unfinished business of the aid effectiveness agenda.

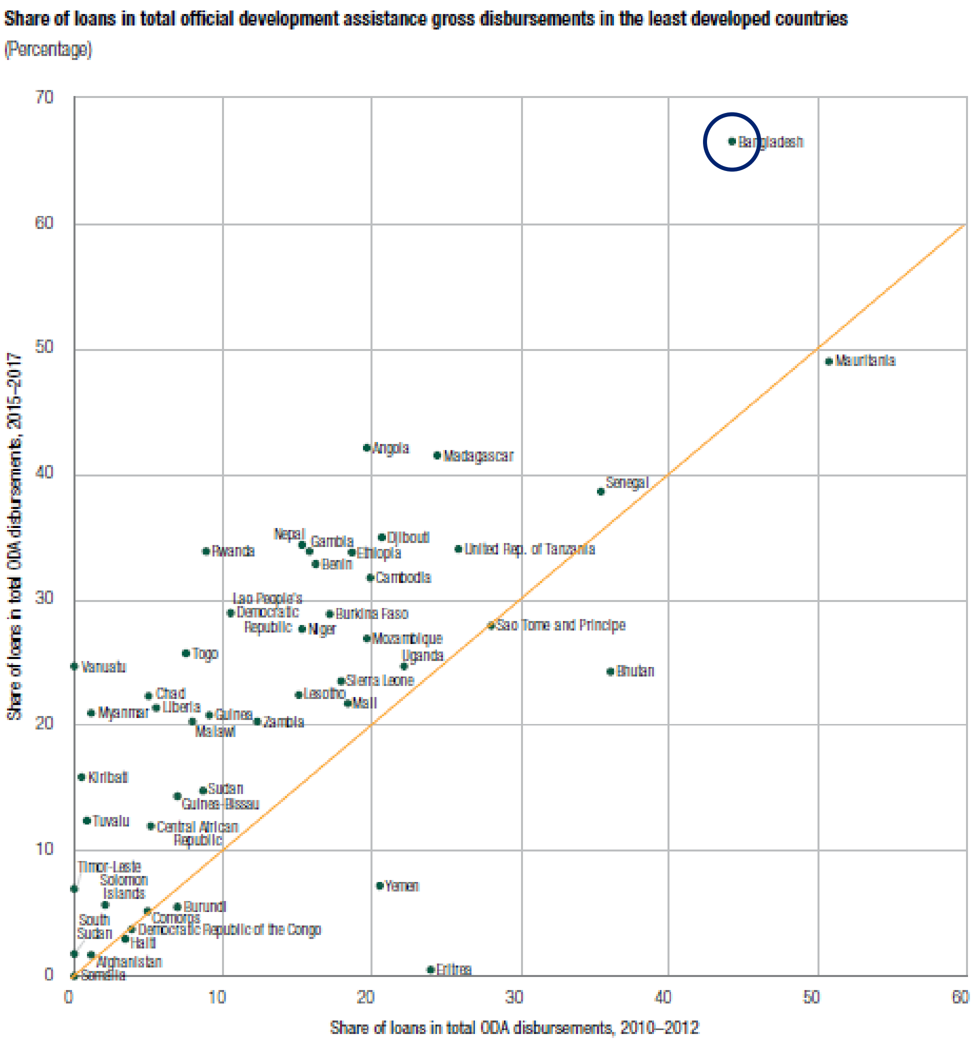
The evolving terms of Aid Dependence

- Social sectors (social infrastructure and services) are the primary target of ODA disbursement to LDCs
- "Social overhead capital" embodies significant productivity spillovers



- In the context of the LDCs, development cooperation should also help to reduce infrastructure gaps and improve production capacities, as appropriate, according to country priorities
- The post-2015 "modernized" ODA criteria introduce new definitions, instruments and modalities that have expanded the scope of ODA beyond State/public funds
- The resulting landscape is more complex, with non-State actors now playing an increased role in development cooperation

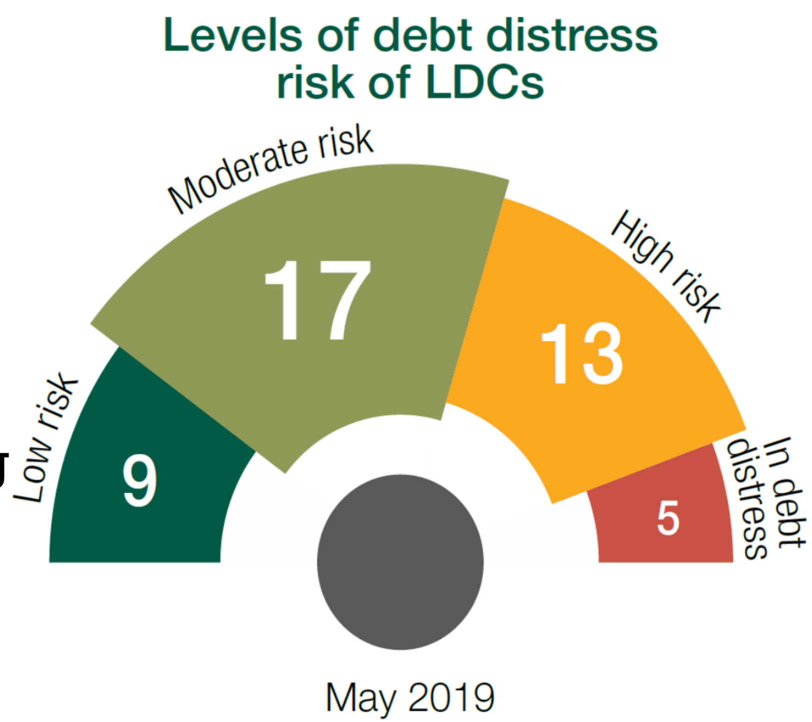
The evolving terms of Aid Dependence



- There is also a reduced emphasis on concessionality, coming on the back of an already depressed development financing situation for developing countries
- LDCs are increasingly resorting to more expensive and riskier sources of finance
- Bangladesh had the highest share of loans in total official development assistance gross disbursements around 45% in 2010-2012 and above 65% in 2015-2017

The evolving terms of aid dependence

- Modest expansion in total gross disbursements to LDCs recorded between 2011 and 2017 has been due to the increase in ODA loans (expanding at a rate of 14% per year), while ODA grants have remained virtually stagnant and equity investments declined
- Debt financing (both concessional and non-concessional) has triggered a sharp expansion in the external debt stock, which raises concerns for debt sustainability.
- Foreign debt of LDCs more than doubled from $146 billion in 2007 to $313 billion in 2017
- Decline in concessionality is affecting the majority of LDCs - weight of loans in ODA has also been growing massively, topping 25% by 2017

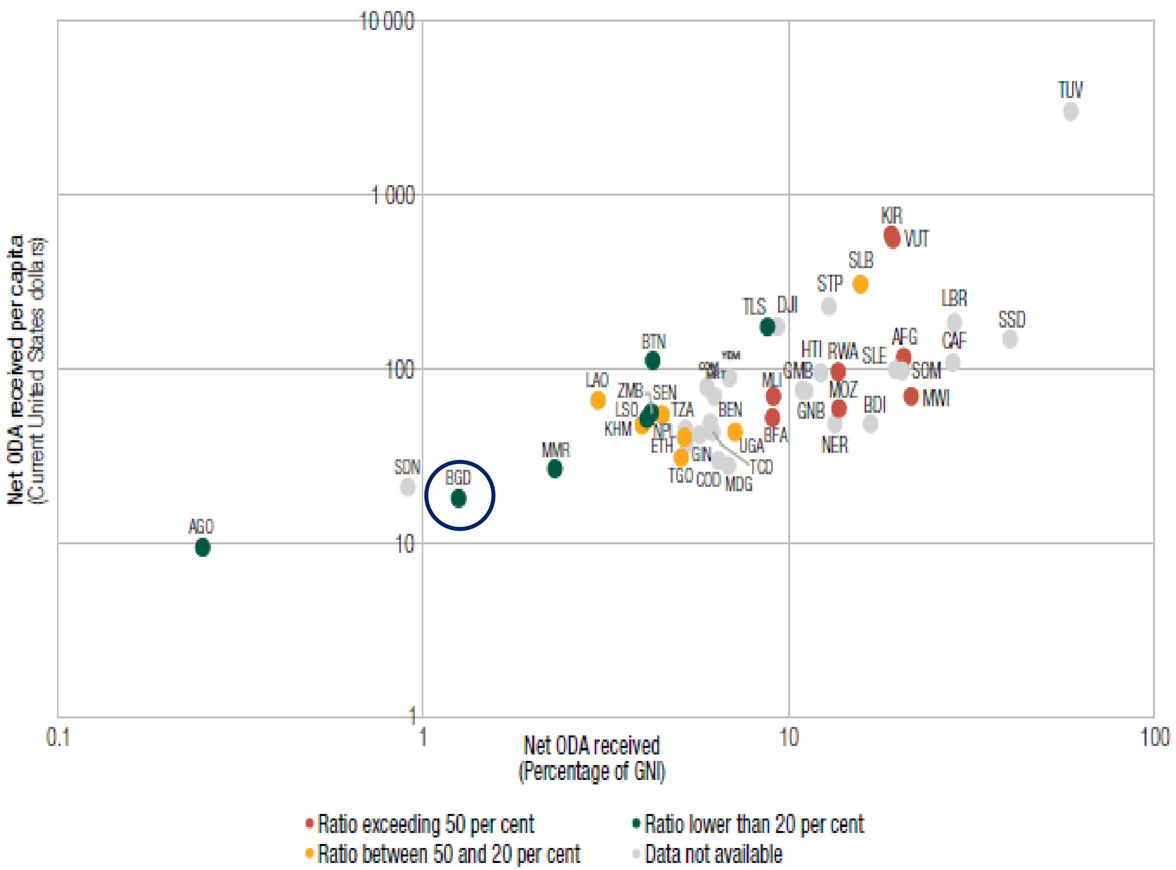


The evolving terms of aid dependence

The size of the official flows to the LDCs

Aid dependence across the least developed countries, 2015–2017

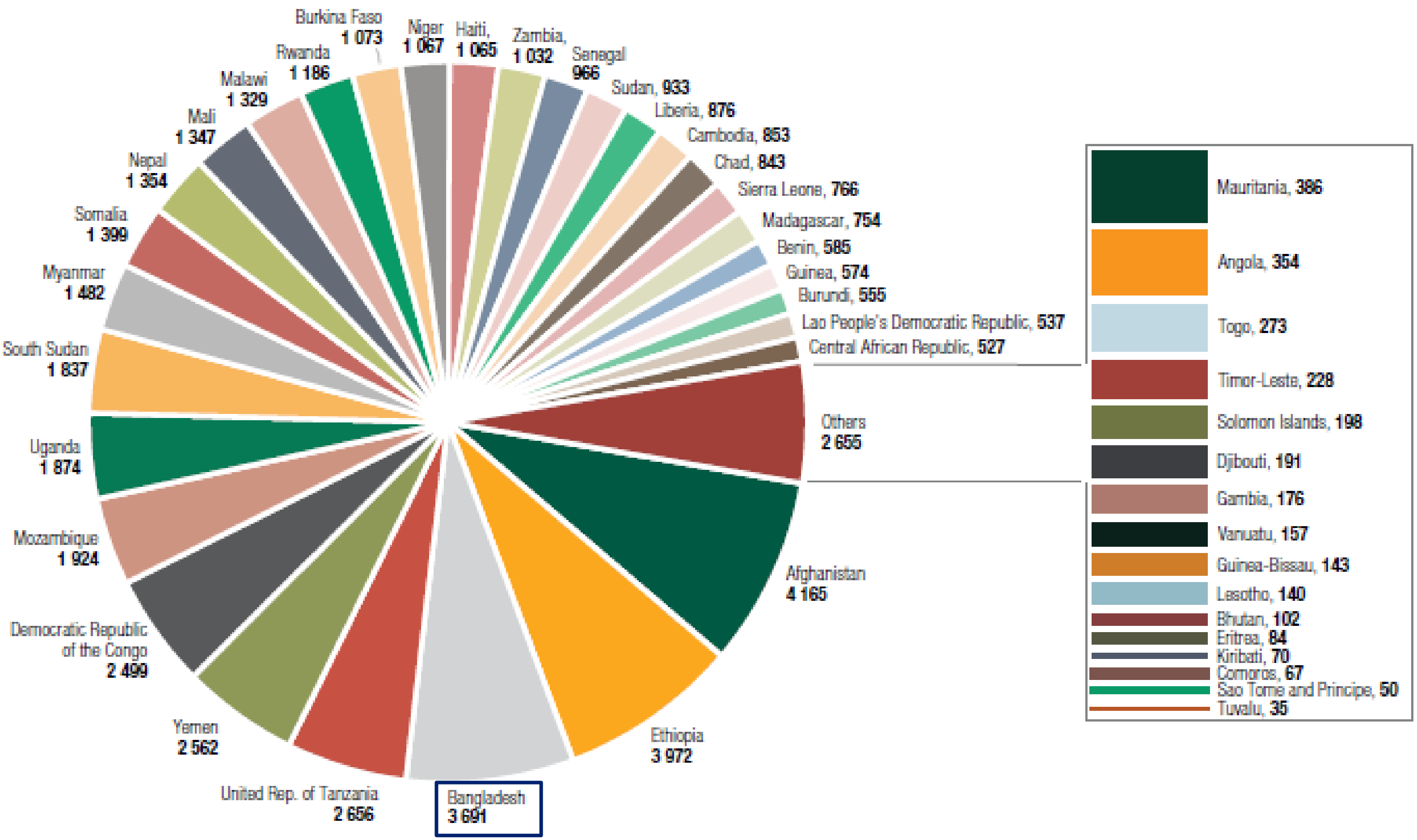
(Logarithmic scales)



- The aid dependence of Bangladesh had a ratio lower than 20%
- This indicates the ratio between net ODA received on central government expenditures

The evolving terms of aid dependence

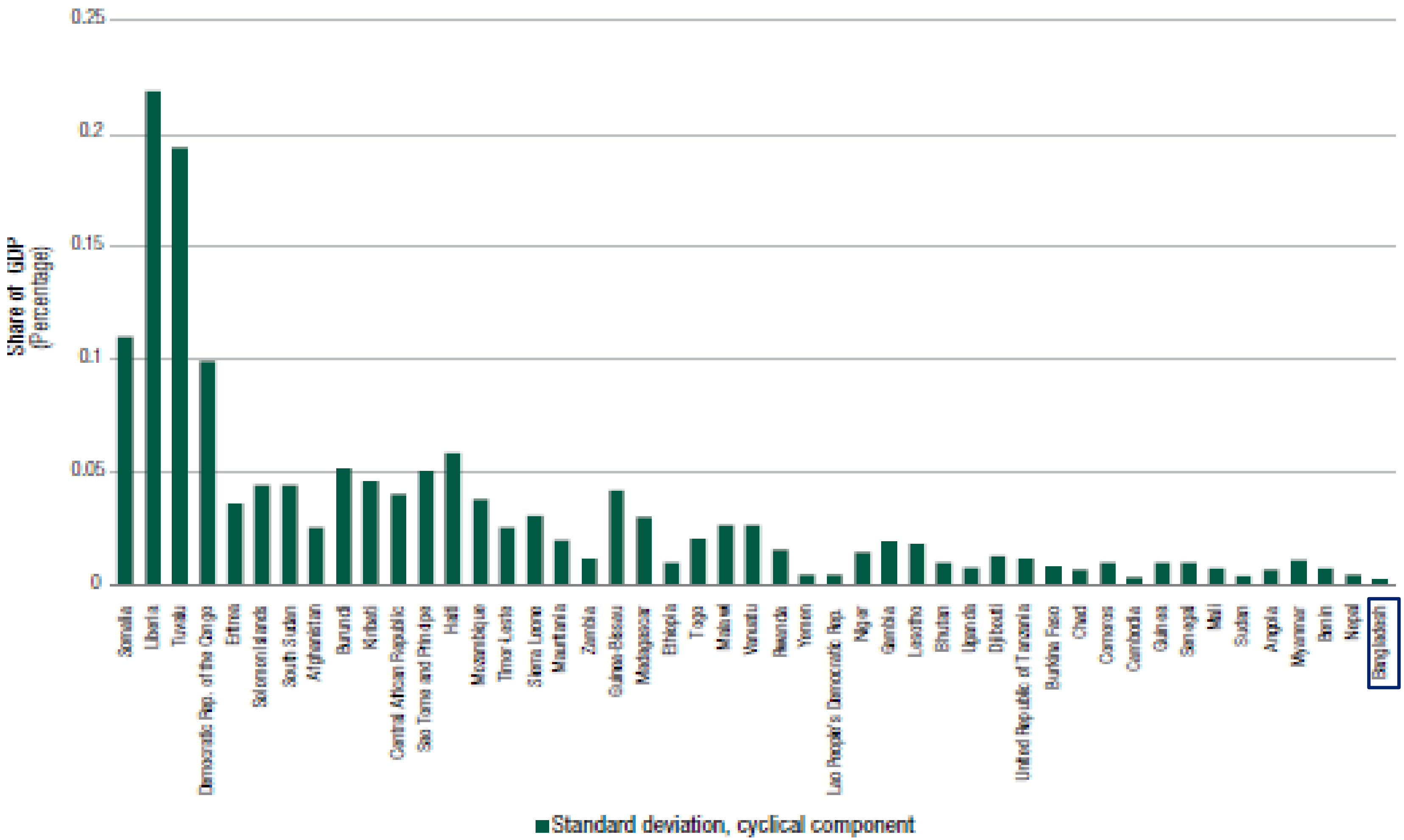
Distribution of gross disbursements of official development assistance, 2015–2017



CENTRE FOR POLICY DIALOGUE

The evolving terms of aid dependence

Volatility of net official development assistance disbursements, 2002–2017



Private development cooperation: More bang for the buck?

- As part of the evolving ODA landscape, donors are extending ODA-backed support to the private sector, thus giving the private sector an official role in development cooperation
- There are several modalities through which private sector engagement occurs
- The most prevalent is the use of ODA- backed Private Sector Instruments (PSIs) and co-investment by bilateral, regional and multilateral DFIs
- The sectoral distribution of mobilized private capital in LDCs shows a concentration in revenue-generating sectors and growth markets
- There is also a predominant role of credit guarantees as the instrument of choice

Private Development Cooperation: More bang for the buck?

Distribution of privately mobilized capital among top 20 beneficiary countries, 2012–2017
(Billions of dollars)

- The top three recipients accounted for nearly 30% of all additional private finance and the top 10 countries, almost 70%
- In 2012-2017, among LDCs, the beneficiary country with the greatest amount received was Angola at \$1.084 billion, followed by Senegal, at \$0.895 billion, followed by Myanmar at \$0.872 billion, followed by Bangladesh at \$0.794 billion

Private development cooperation: More bang for the buck?

Challenges of private development cooperation

- Lack of a standard definition of private sector engagement hinders provision of additionality
- There is thus a risk in providing ODA-backed financial support to the private sector, which increases competition with the State for access to development finance
- Managing donor self-interest is a foreseeable challenge for LDCs, especially since the relationship between "shared values" and strategic interests of partners is not free of tensions. For example, subsidies provided by donors could substantially jeopardize competition and lead to unfavourable market structures in recipient LDCs.

Private development cooperation: More bang for the buck?

Challenges of private development cooperation

- Avoiding relegation to a bystander role will be key for LDC Governments
- The quality of the multiparty partnerships that LDC Governments will be able to broker with the private sector and other stakeholders is a key area of concern
- It requires better accountability relationships between different actors. Also, development finance institutions are structured to be profit-driven, thus their business model could be a poor match for some business segments in the LDCs
- The distribution of funds raised through private sector engagement is uneven and concentrated in a few countries. The top three recipients (Angola, Senegal and Myanmar) accounted for nearly 30% of all additional private finance and the top 10 countries almost 70%

Private development cooperation: More bang for the buck?

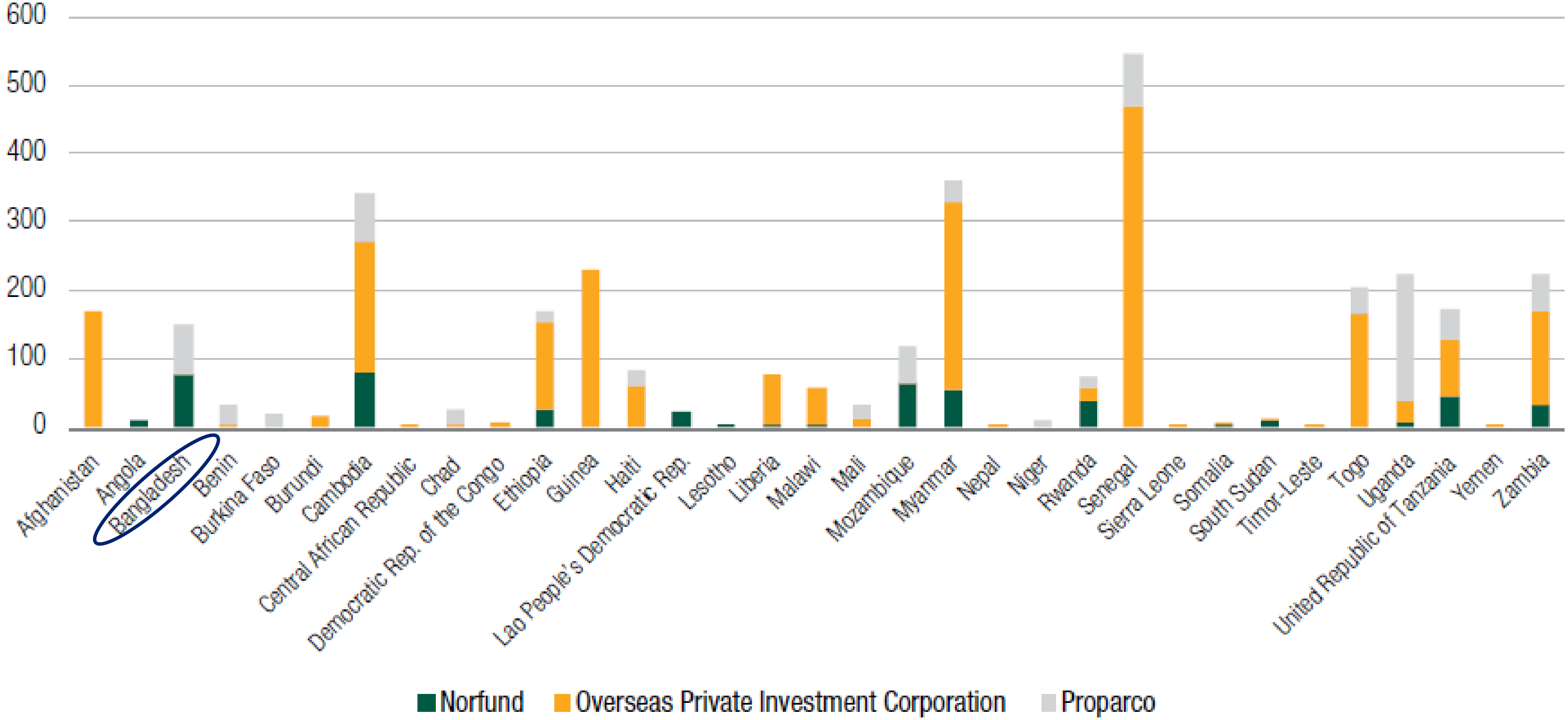
Challenges of private development cooperation

- From 2012 to 2017, multilateral organizations provided the largest share (52%) of privately mobilized capital flows for development in LDCs. Bilateral donors contributed 47% of private sector investments
- Up to 36 LDCs received additional private capital inflows between 2012 and 2017. However, not all of them achieved additional financing every year. Up to 30% of LDCs do not attract additional private capital on an annual basis. This underlines the fact that private capital (even when backed by ODA) does not represent a viable source of development finance for many LDCs and is an unpredictable source for the majority

Private Development Cooperation: More bang for the buck?

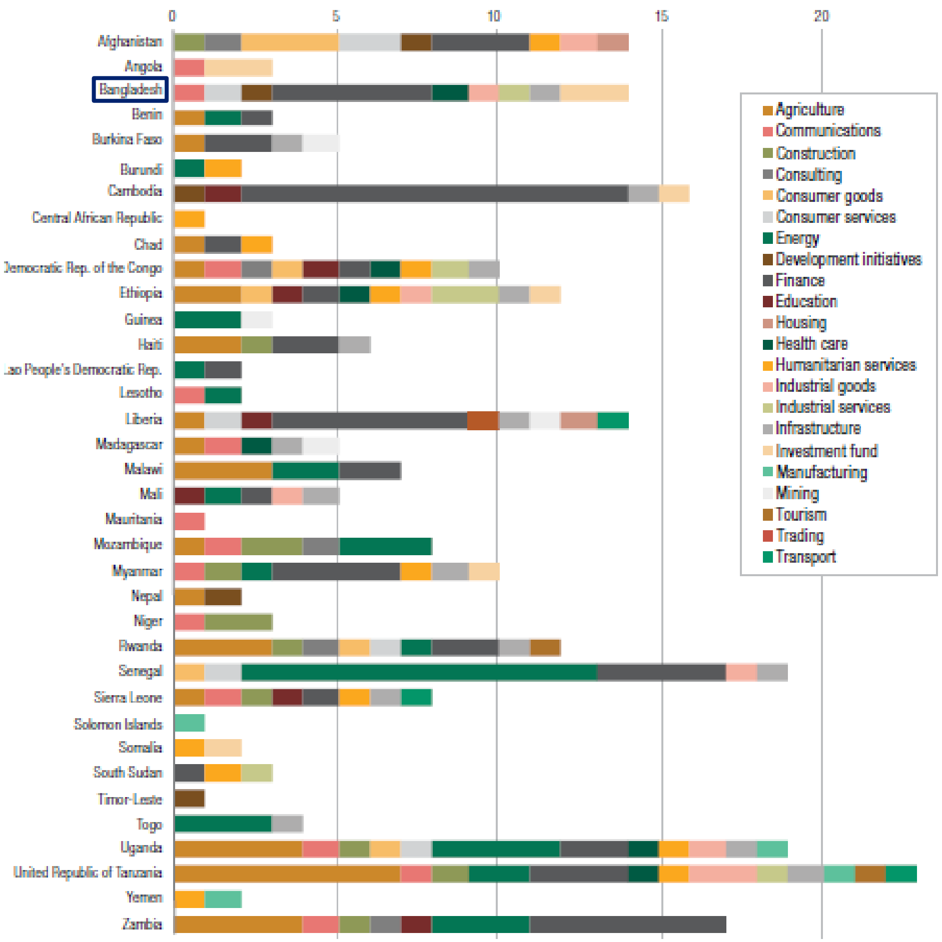
Selected development finance institutions: Active investments in the least developed countries, 2017

(Millions of dollars)



Private Development Cooperation: More bang for the buck?

Selected development finance institutions:
Sectoral composition of active investments in the least developed countries, 2017
(Number of projects)

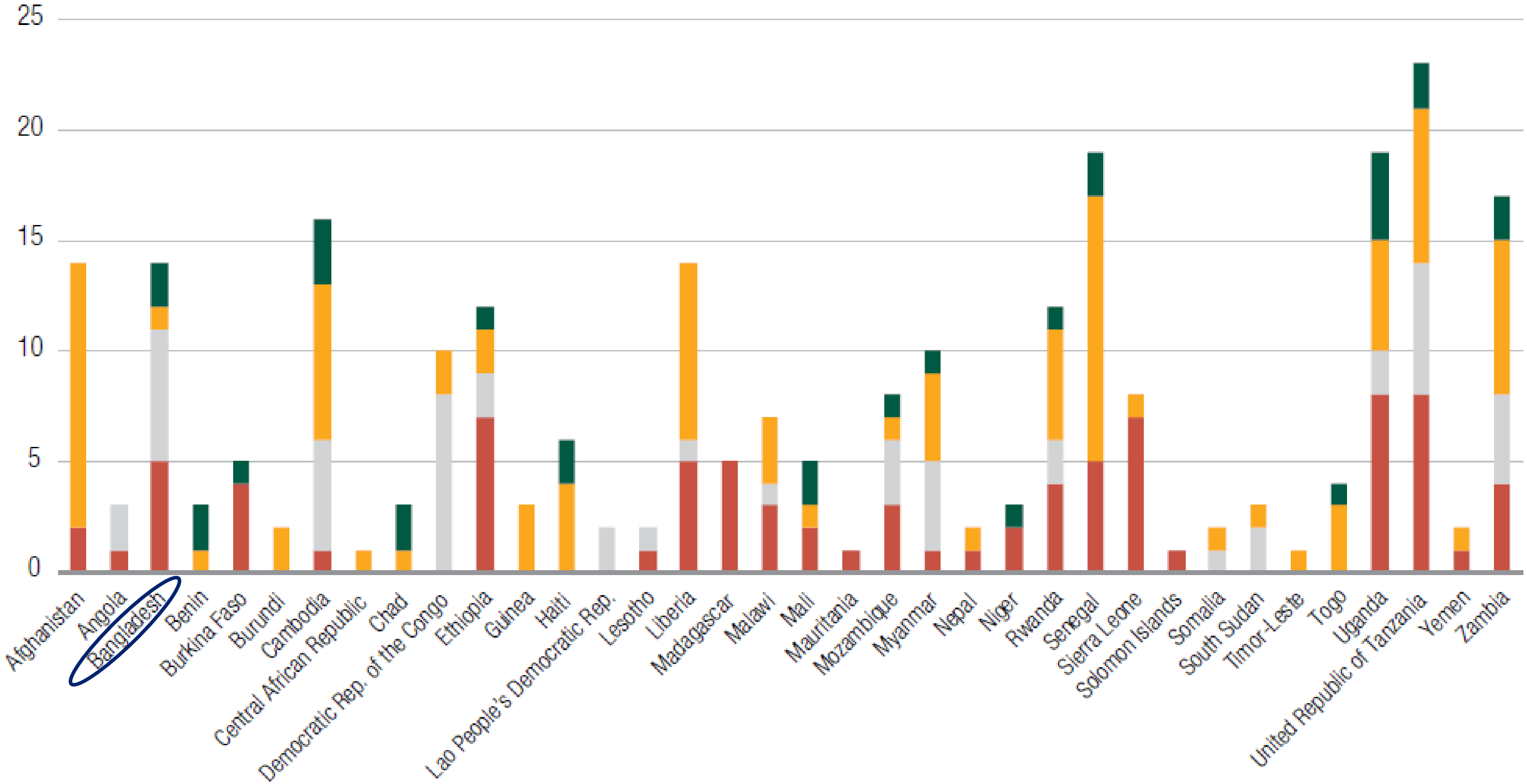


- In case of Bangladesh's sectoral composition of active investments, European development finance institutions have been found to show a bias towards the financial sector, followed by a focus on investment fund and industrial services as the top three areas of concentration

Private Development Cooperation: More bang for the buck?

Presence of selected development finance institutions in the least developed countries

(Number of projects)



Case Study: The experience of Bangladesh in development finance institution investment

The following points were determined based on a review of 240 private sector engagement projects:

- DAC donors dominate private sector engagement mobilized through development cooperation (37%), multilateral development finance institutions (33%) and bilateral development finance institutions (25%)
- The predominant private sector instrument is financing, mainly debt financing, primarily in the financial sector, agriculture, manufacturing and energy. Finance underpins 71% of the projects examined, with debt financing supporting 42% of projects overall.
- Large domestic companies remain the most prominent partners in private sector engagement projects in Bangladesh.
- The total size of public or private contributions for private sector engagement projects cannot be determined due to lack of transparency.

Case Study: The experience of Bangladesh in development finance institution investment

- The main activities supported by private sector engagement projects include improving access to finance for small and medium sized enterprises and/or a specific sector, technology or research-related interventions in agriculture and financing company operations, including expansion activities and upgrades.
- The extent to which the activities of private sector engagement projects support specific sectoral policy objectives is unclear, even if the sectors chosen by development finance institutions align with the general priorities of the national development plan.
- Private sector engagement projects could benefit from more inclusive partnerships and support greater country ownership; government institutions are listed as partners for only 9% of the projects, while 8% involve civil society organizations and less than 1% involve domestic business associations.

Case Study: The experience of Bangladesh in development finance institution investment

- Private sector engagement interventions with regard to the business enabling environment tend to neglect support for government capacity to move from policy formulation to implementation, including with regard to carrying forward existing projects and programs, ensuring compliance with laws and regulations and establishing greater coordination and consistency across the Government with regard to interaction with the private sector.
- Only a limited number of the examined projects (12%) explicitly target the poor or people living in underserved or rural locations. Only 4% explicitly target women.
- Most private sector engagement projects are subject to regular monitoring at annual or more frequent intervals and, to a lesser extent, through field visits. More development partners could make project-specific monitoring provisions and the intermediate and final results from evaluation publicly available.
- Only 3% of examined projects provide evaluation information and another 4% outline how evaluation will occur. The focus seems to be on publicizing institutional approaches and policies for evaluation, as is the case for 65% of the projects

External development finance and fiscal space

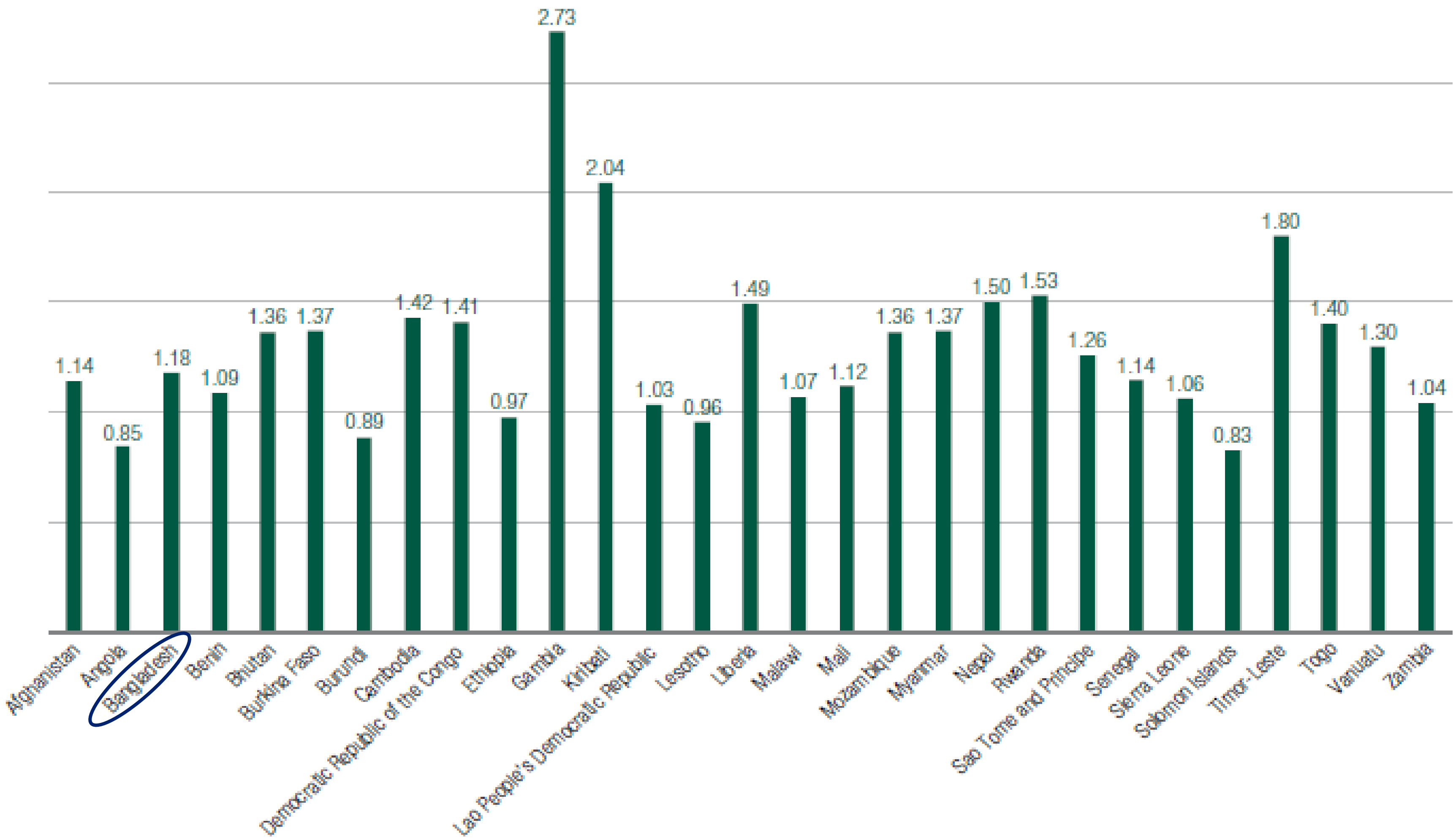
- Private investment drives economic activity but requires substantial complementary public investments in LDCs. Most LDCs face long-term fiscal deficits indicative of consistently low revenue but also increased expenditure on public goods and services.
- From 2000 to 2017 domestic public debt exceeded ODA in 40% of LDCs. Diversified tax structures are now featuring, with taxes on goods and services playing an increasingly important role
- However, LDCs' fiscal capacities (fiscal space) are limited by weak growth of their tax bases
- Most LDCs face structural imbalances indicative of consistently low revenue but rising public expenditure
- Thus fiscal reform efforts will not be adequate for them to solve the financing constraints to enable them to achieve structural transformation and sustainable development

External development finance and fiscal space

- LDCs' tax revenues increased from an average of 11% of GDP in 2000 to 19% in 2017; above the 15% minimum threshold widely regarded as necessary to support sustainable growth and development
- Many LDCs have tax bases that are narrow and highly susceptible to negative shocks, resulting in periods of expansion and contraction in fiscal space. Budget deficits widened from an average of 1.8% of GDP in 2013 to 3.6% in 2018
- LDCs need to continue to improve tax efficiency and collection efforts, but weak progress on structural transformation constrains the expansion of tax bases and will sooner or later limit further enhancements in domestic revenue mobilization
- LDC exposure to tax avoidance and illicit financial outflows by multinational enterprises was estimated at 36–115% of tax revenue in 2018. Other factors that reduce the tax potential in LDCs are weak institutions and policies, large informal sectors, tax evasion and corruption

External development finance and fiscal space

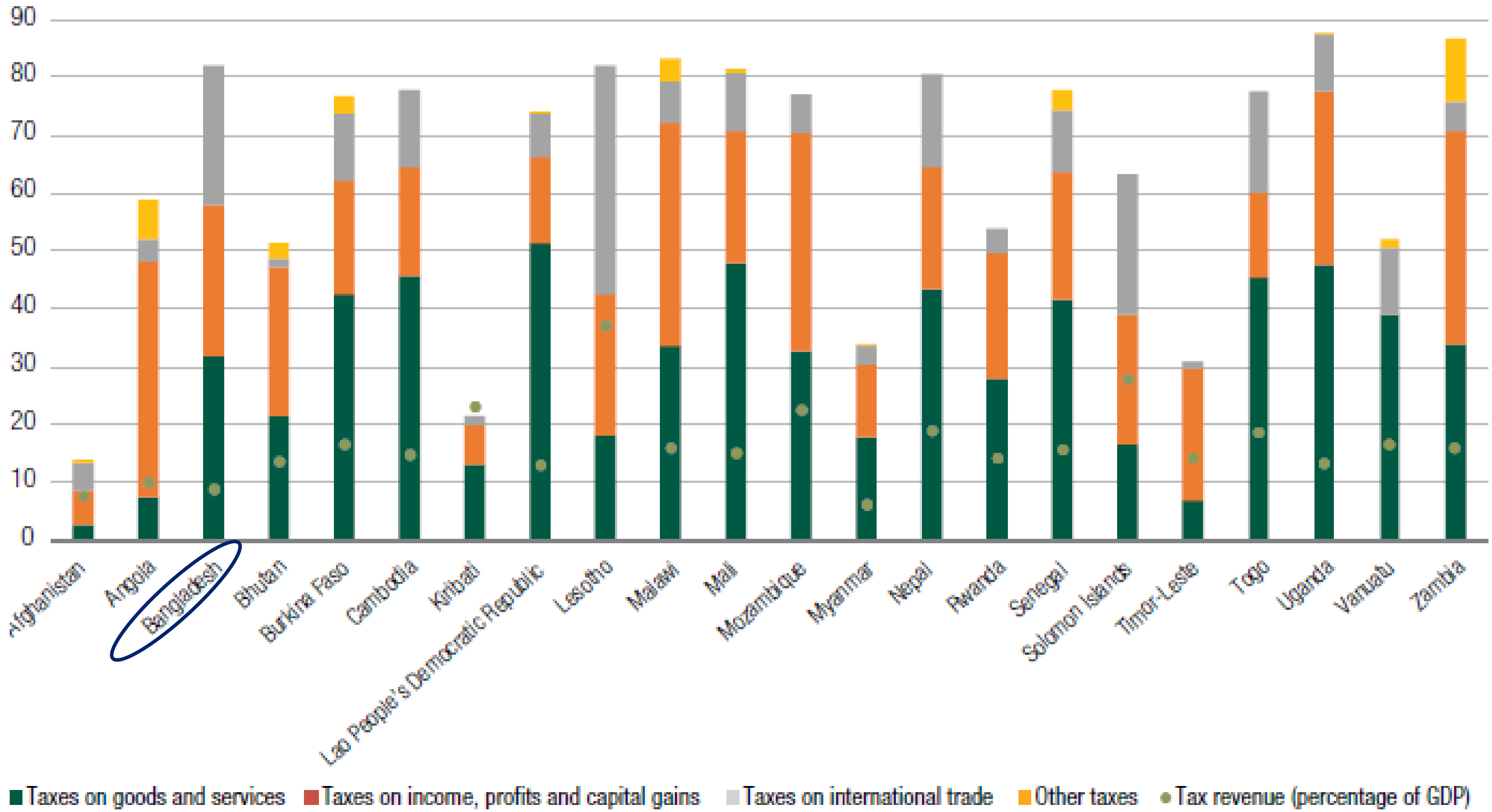
Estimates of tax buoyancy in selected least developed countries, 2002–2017



External development finance and fiscal space

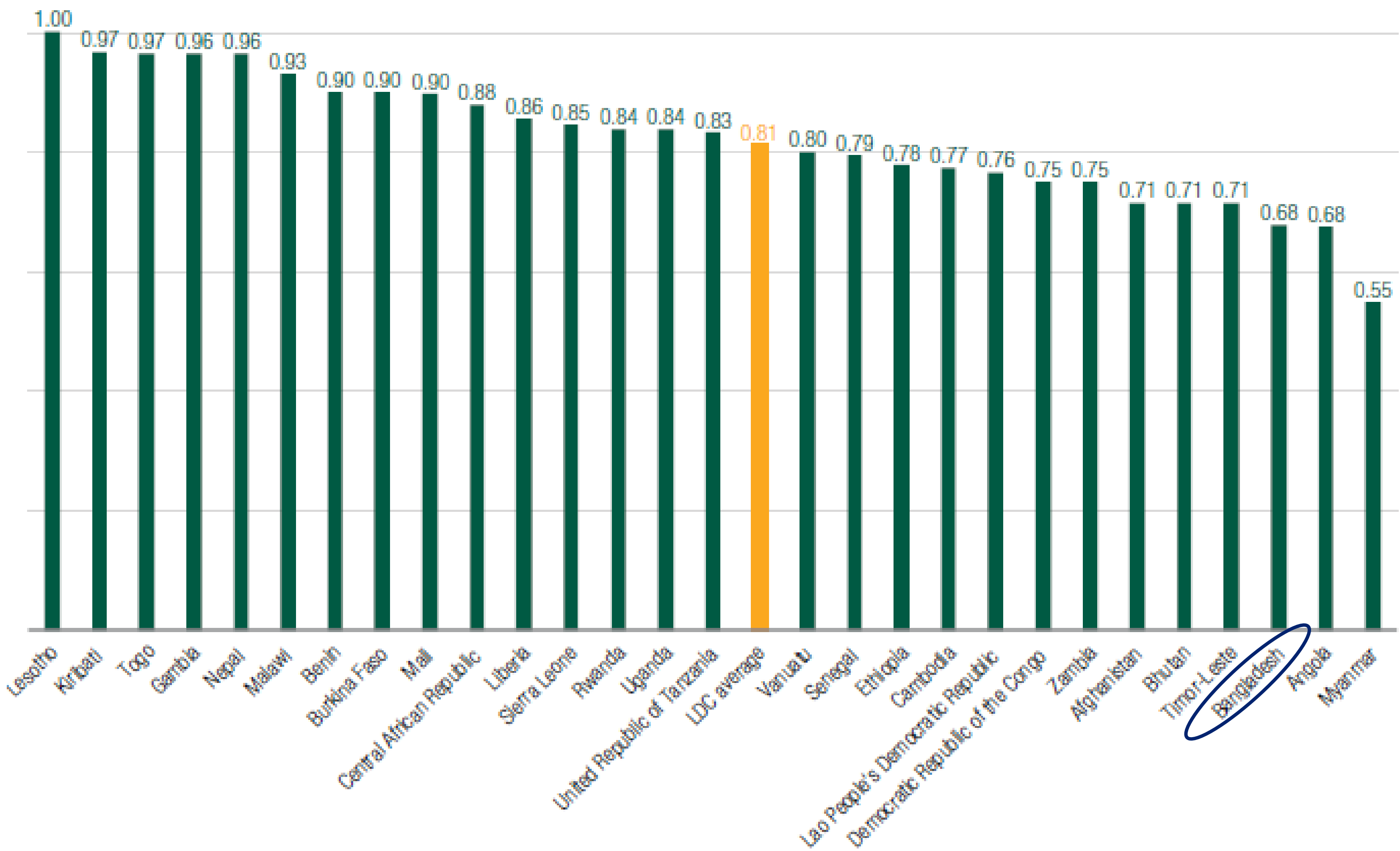
Contribution of various components to tax revenue in selected least developed countries, average, 2015–2017

(Percentage)



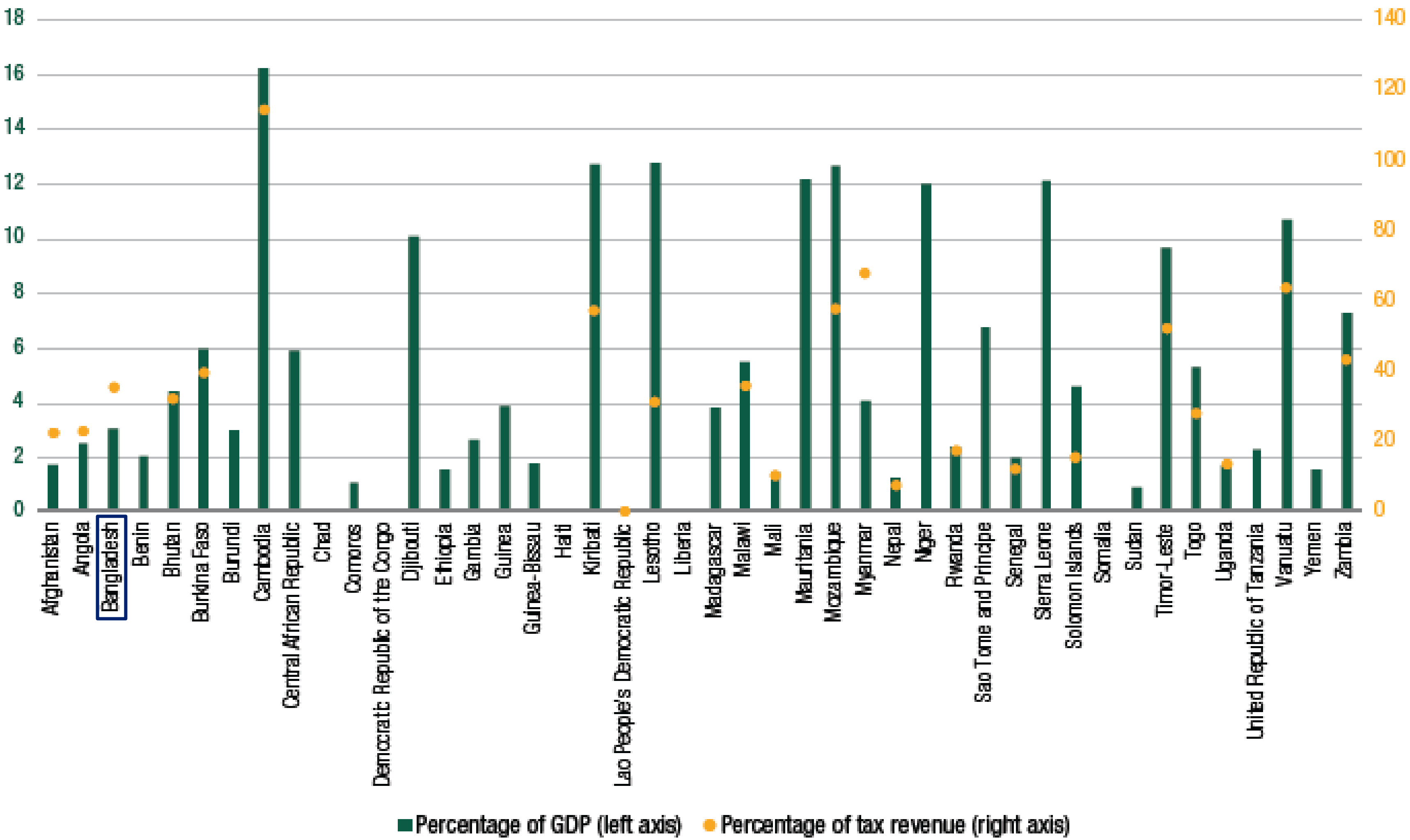
External development finance and fiscal space

Tax effort in selected least developed countries, average, 2007–2016



External development finance and fiscal space

Illicit financial flows from selected least developed countries, 2015

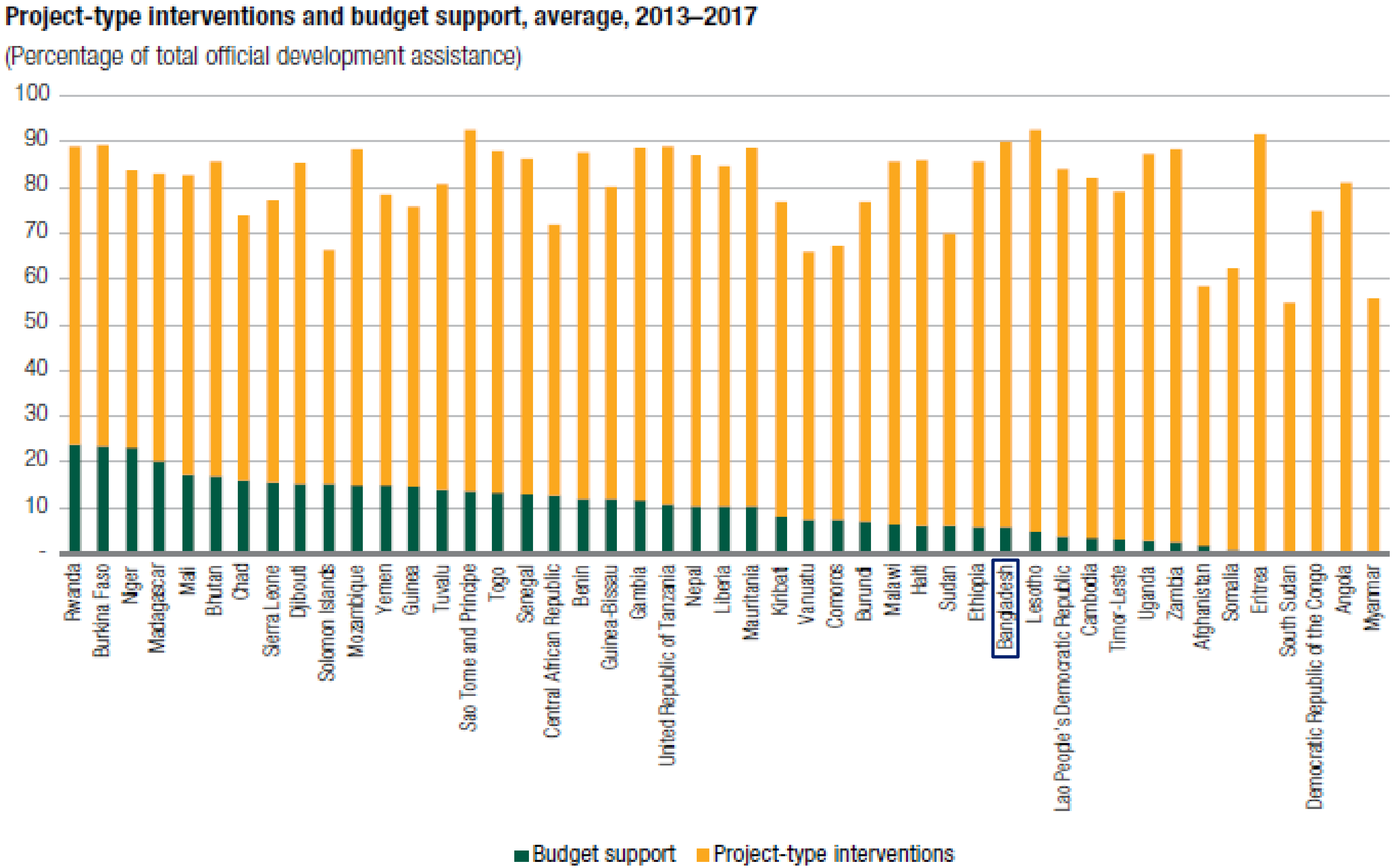


External development finance and fiscal space

ODA delivery challenges LDC fiscal management

- Strengthening domestic public resource mobilization is critical to closing the development financing gaps in LDCs
- The Addis Ababa Action Agenda specifically highlighted the complementary role that international public finance plays in the poorest and most vulnerable countries
- In the Agenda, countries committed to "…further strengthen the mobilization and effective use of domestic resources…"
- However, misalignment between ODA sectoral allocation and national priorities of LDCs impacts on their capacity to accelerate structural transformation, further potential to mobilize additional domestic resources and chances of graduating from the category
- A country-owned development process is one in which there is a significantly reduced role for project-type funding or core contributions and, critically, one in which national systems play a significant role in policy formulation and the deployment of resources

External development finance and fiscal space



External development finance and fiscal space

International community is not adequately assisting LDC fiscal management

- Donors have not shifted from a concentration in the social sector since era of the MDGs, and the fragmented bilateral channels of aid delivery have intensified this concentration
- Misalignment between donor and national priorities impacts on the capacity of LDCs to effectively deploy their fiscal policies
- The misalignment costs may rise due to the lack of complementarity and synergy between external public resources and domestic public resources
- LDCs have also been affected by significant levels of illicit financial flows, which further erode the taxable base. New forms of cooperation should complement ODA, not worsen ODA fragmentation and their debt burden
- In 2017 only 32% of donor initiatives had objectives drawn directly from national development plans. Most aid is delivered through parallel donor structures that tend to weaken the complementarity between external finance and domestic tax effort. Parallel structures also divert resources from planned national priorities

The Bangladesh Context

- Bangladesh is one of the fast growing economies within the LDC group
- Resource gap in Bangladesh was lower than LDC average – is it because of rather stagnating private investment?
- Remittance for Bangladesh proved to be critical for financing balance of payments
- Bangladesh is one of the major recipients of ODA within the LDC group – largely due to the size of the economy
- The country has less dependence on ODA for financing budget and in terms of other economic parameter
- In last one decade, ODA to Bangladesh has been less concessional – loan-to-grant ratio increased drastically (third highest among LDCs)
- ODA to Bangladesh is less volatile

The Bangladesh Context

- Budgetary support for Bangladesh is not significant; ODA is mostly channeled through project financing
- Key challenges for Bangladesh include lower ODA utilization capacity and growing debt stress (both domestic and foreign)
- Privately mobilised capital under development cooperation in Bangladesh was fourth highest among the selected 20 LDCs – but not necessarily focused on development effectiveness
- The predominant private sector instrument is financing, mainly debt financing, primarily in the financial sector, agriculture, manufacturing and energy
- Only a limited number of the examined projects (12%) explicitly target the poor or people living in underserved or rural locations

The Bangladesh Context

- Bangladesh's tax GDP ratio is significantly lower than LDC average
- Tax buoyancy and Tax efforts are also very low compared to the LDC counterparts
- Dependence on taxes on international trade is much higher in Bangladesh
- Bangladesh's exposure to illicit financial flow is very high

Aid Effectiveness Agenda 2.0

- It will be necessary to revitalize the aid effectiveness agenda established by the Paris Declaration of 2005 on the quality of aid and its impact on development to take into account a significantly changed aid and development finance landscape
- LDC Governments on their part must assume the driver's seat of their development agenda and take a more proactive role in managing the allocation of external development finance in alignment with national development priorities
- On the other hand, the international community needs to step up their related support towards this common goal
- To achieve this objective, the LDC Report 2019 proposes an action plan to implement the "Aid Effectiveness Agenda 2.0"

Policy options

Actions by LDCs on national coordination of external finance

- Domestic coordination of all external development finance
  - Clarify decision making
  - Adopt mechanisms for efficient disbursement and safeguarding fiscal space
  - Align external support with national development plans
  - Enforce mutual accountability, transparency and monitoring
- Strengthen State capacity to drive structural transformation & sustainable development
  - Effectively mobilize and manage domestic resources
  - Boost institutional capacities
  - Establish synergy: aid ⇔ domestic resource mobilization

Policy options

Actions by the International community in support of LDCs

- Traditional donors to adhere to commitments reaffirmed in SDGs
  - Align support with beneficiary country priorities
  - Eliminate State-weakening practices and contribute to State building
  - Enhance transparency
  - Strengthen South-South Cooperation
- International decision-making - Adequate representation and effective voice for LDCs in multilateral discussions on systemic issues:
  - Debt sustainability
  - Tax matters
  - Access to international liquidity
  - Climate-related ODA

Where to start?

LDCs can leverage

LDC V (Doha, 2021)

as crucial occasion to rally the international community to act on their development financing challenges

THANK YOU