Background Note

G20 Finance Ministers and Central Bank Governors Meeting
Washington, DC

Ministerial Working Dinner on low income developing countries (LIDCs)

The LIDC group includes all countries whose per capita income falls below US$2,500. There are 60 countries in this group, accounting for about one-fifth of the world's population. LIDCs have delivered strong growth performance over the last fifteen years. Between 2000 and 2013, LIDCs recorded average real GDP growth of 6½ percent, up from 3.6 percent during the 1990s and on par with the performance of emerging economies. The growth pick-up was particularly marked for countries in Sub-Saharan Africa (SSA) and the transition economies of Central Asia, but also significant in Asia and Latin America.

LIDC growth showed notable resilience during the 2009 global financial crisis, providing a marked contrast with the outcome in the wake of previous global shocks. GDP growth in 2009 remained positive in over 80 percent of LIDCs; average growth was in the order of about 6 percent, 1 point less than the five-year pre-crisis average.

The improved growth performance over the past fifteen years reflected favorable external conditions (for most of the period) and better economic policies. LIDCs benefited from robust commodity prices, the emergence of China as an important trade and investment partner (particularly in SSA), and increased capital inflows (taking the form of FDI in growing extractive industries in most countries). Countries burdened with high debt levels benefited from international relief initiatives (HIPC/MDRI) that created room to finance development spending.

On the domestic side, improved macroeconomic management contributed to lower inflation and growth volatility compared with the pre-2000 era. Countries also implemented wide-ranging market-oriented reforms in the real and financial sectors, facilitating private sector development.

Commodity exporters experienced both above-average growth—although not by a large margin—and significantly higher output volatility, the latter linked to export price volatility.

Fragile states experienced below-average growth along with higher output volatility—consistent with several studies of the impact of fragility on economic performance. Some one-fifth of LIDCs failed to record any growth in output per capita over the period, thereby falling well behind other LIDC peers.

LIDC growth has been primarily driven by factor accumulation rather than productivity gains. Growth in most LIDCs has not been accompanied by substantial structural transformation.

A significant fraction of the population in LIDCs is employed in agriculture (particularly in SSA economies), where labor productivity on average has grown slowly.

The manufacturing base has remained narrow in the average LIDC, but with important regional differences: the share of manufacturing in GDP was higher in Asia's LIDCs, a number of whom (e.g., Vietnam and Bangladesh) are well integrated into global manufacturing value chains, but quite limited (and declining) in most SSA economies.

Services account for close to half of GDP in most countries, albeit reflecting a combination of a high productivity "modern" sector and a low productivity informal sector.

LIDC's Progress toward meeting MDGs has been mixed. 16 out of 60 LIDCs— such as Ghana, Senegal, Uganda, and Vietnam—have already met the target for extreme poverty reduction, 20 countries—17 of them in SSA, and 12 are fragile states—are considered seriously off target.

Progress has also been slow in regard to other goals, such as primary school completion rate, infant mortality rate, access to an improved water source. A large number of LIDCs are projected to meet the targets only after 2020. However, in relative terms, by taking into account their initial conditions when MDGs were launched, many SSA countries have significantly improved their development indicators over the past 15 years.

LIDCs may face greater headwinds in the period ahead, as the global growth is expected to be significantly lower than an average recorded before the global financial crisis.

With declining commodity prices and stagnation (and decline in some case) of aid flows, external conditions will be less supportive to LIDC growth compared to the period before the crisis.

According to the *2015 UN World Economic Situation and Prospects*, GDP in LIDCs is expected to grow by 4.9 per cent for 2015, and 5.3 per cent for 2016, lower their average growth before the global financial crisis, but slightly better than the projected growth for developing country as a whole.

The projected growth in LIDCs will be led by continued efforts to implement critical reforms and improve business environment. Progress in rebuilding peace and stability and implementation of structural reforms (e.g., energy subsidy and civil service reforms) is expected to benefit fragile states. Downside risks include a weakening of macroeconomic policies, adverse global spillovers, sharp weakening in commodity prices, and natural disasters.