PrepCom 1
THEMATIC PANEL DISCUSSIONS

UN-OHRLLS

LDC5
5TH UNITED NATIONS CONFERENCE ON THE LEAST DEVELOPED COUNTRIES

Issues Note for Theme 6

Mobilizing international solidarity, reinvigorated global partnerships and innovative tools for risk-informed sustainable development - A march towards sustainable graduation

Issues Note

LDCs are largely dependent on public resources - both domestic and foreign - to finance sustainable development needs and ensure a smooth transition from the LDC category as foreseen in the IPoA. However, such public resources have not been sufficient to cover the growing needs of LDCs and have increased only slowly in the past.

The financing challenges of LDCs have been exacerbated by COVID-19. On average, GDP in LDCs is estimated to have declined by 1.3 per cent in 2020, according to latest available projections by UN DESA. This is a quite stark difference to the projected 5.1 per cent GDP growth in LDCs at the beginning of 2020 and well below the IPoA target of 7 per cent.[1]

Support for domestic resource mobilization and fight of illicit financial flows

Before the pandemic, the median tax-to-GDP ratio in LDCs increased very slowly, from 13.3 in 2011 to 16.2 in 2018, well below the level of higher income countries, and insufficient to meet the SDGs. These low ratios are due to their economic structures, high poverty rates, weak tax administration and the nature of their tax systems. In several LDCs the rate was lower than 10 per cent. LDCs rely predominantly on taxes on goods and services followed by income taxes, which were significantly reduced by the effects of COVID-19 and efforts to reduce its economic impact. At the same time LDCs increased spending due to increasing needs across all sectors. Thus, fiscal deficits in LDCs that have been widening before COVID-19 increased further, resulting in more limited fiscal space and increasing debt.

Efforts to increase government revenue have been under way in many LDCs, including broadening of the tax base and enhancing compliance and ways to make further progress need to be explored. Digitizing tax systems can also contribute

---

[1] For these and subsequent figures see mainly the Secretary-General's Report on the Implementation of the IPoA (A/76/71-E/2021/13)

towards improving tax collection and transparency of public financial management. At the same time fiscal policy needs to be used to reduce inequality.

Another challenge for LDCs are tax evasion and illicit financial flows. Resource extraction is often under-taxed and multilaterals investing in LDCs use tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations. Enhanced participation of LDCs in international tax cooperation and repatriation of IFFs are among the issues where progress is needed.[2]

Traditional and innovative sources of finance to meet the funding gaps in LDCs

ODA to LDCs by Development Assistance Committee (DAC) members was already declining in real terms over the past decade. After an increase in ODA from DAC donors to LDCs from 2017 to 2018, it declined by 6 per cent in 2019. The average share of gross national income (GNI) provided as ODA to the LDCs from DAC donors declined from 0.1 per cent in 2011 to 0.09 per cent in 2019, when only 5 DAC donor countries met the IPoA the target of committing 0.15 per cent or above of their gross national income as ODA to the LDCs, compared to ten donor countries in 2011. The share of total ODA allocated to LDCs declined from 33 per cent in 2011 to 30 per cent in 2019 and the percentage of ODA to LDCs in the form of grants declined from about 93 per cent in 2015 to 90 per cent in 2018. Gross ODA disbursements made up 5.1 per cent of GDP and around 40 per cent of government spending of LDCs in 2018, which makes it a larger share of the financing mix than for other groups. As ODA plays an even larger role in resources for social sectors, such as health care or water and sanitation, for which it is difficult to attract private finance, it has a crucial role in containing COVID-19 and laying the foundations for long term development.

According to the latest OECD data, bilateral ODA to LDCs increased by 1.8% in 2020, which is lower than the overall increase in ODA, further reducing the share of ODA to LDCs.[3] However, LDCs should be given priority to grant finance as they are not only the most vulnerable countries but also have least access to other sources of finance. Concessional finance could also be increased through accelerated replenishment of concessional finance windows of multilateral development banks and the recapitalization of these banks. Mechanisms like the use of the LDC criteria for ODA allocation could be further explored. In addition, measures to enhance the quality of ODA, for example alignment with country priorities in line with the SDGs, need to be implemented. Likewise, improved South-South and triangular cooperation could benefit LDCs.

As traditional sources of finance will not be sufficient to fill the financing gaps of LDCs, innovative sources like blended finance need to be explored. Even before the COVID-19 crisis, blended finance, which is the strategic use of development finance to mobilize commercial finance towards the SDGs, with a focus on unlocking investment that the private sector would not have done on its own, remained limited in LDCs. They continue to receive only 6 per cent of private finance mobilized by official development finance interventions, amounting to approximately US$13.4 billion between 2012 and 2018. While private finance was mobilized in 45 LDCs it is still relatively concentrated in a few countries. Private finance mobilized in LDCs is concentrated in selected sectors, where revenue can be generated, such as energy and banking as well as financial services, while social sectors are mostly excluded.[4]

Blended finance investments provide an opportunity to focus on risk reduction, by investing in projects and sectors that increase resilience of economies and societies to future crises and contribute towards achieving the SDGs. Such

---

[2] UN-OHRLLS (2017) State of the Least Developed Countries 2017 – Follow up of the Implementation of the Istanbul Programme of Action for the Least Developed Countries, Special Theme: Financing the SDGs and IPoA for LDCs. (https://www.un.org/ohrlls/news/state-ldcs-financing-sdgs-and-ipoa-ldcs-2017)
[3] https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2020-detailed-summary.pdf
[4] OECD and UNCDF (2020): Blended Finance in the Least Developed Countries (Home - UN Capital Development Fund (UNCDF))

preventative investments are likely to be less costly than responding to and rebuilding from future disasters and shocks. This includes making ODA loans more effective at mobilizing private capital as well as taking on more risk through focusing on more fragile contexts prevalent in many LDCs, using catalytic instruments and focusing on sectors severely hit by the crisis in such contexts.

Reallocation of SDRs for LDCs

There has been a general agreement among G20 countries to the issuance of new SDRs by the IMF, which could be used to reduce liquidity constraints with no conditions attached. Such SDRs would supplement official reserves and help restore confidence and thus contribute to a resilient and lasting recovery of the global economy. Of a new general allocation, which would be based on the current distribution, LDCs would only receive a relatively small percentage. The G20 Finance Ministers and Central Bank Governors in April 2021 asked "the IMF to explore options for members to channel SDRs on a voluntary basis to the benefit of vulnerable countries, without delaying the process for a new allocation."[5] The modalities for such a reallocation of SDRs need to be beneficial to LDCs and provide additional liquidity for building back better.

Debt relief, debt cancellation initiative through improved international debt architecture

After significant debt relief through HIPC and MDRI, the stock of LDC debt increased again from US$198 billion in 2011 to US$385 billion in 2019. Average public debt in LDCs rose continuously from 34 per cent in 2011 to 53 per cent of GDP in 2019 and jumped to 58 per cent in 2020. Total debt service as a percentage of exports of goods, services and primary income increased from an average of 5 per cent to 13 per cent over the same period.

As of February 2021, 4 LDCs were classified as in debt distress (Mozambique, Sao Tome and Principe, Somalia, and Sudan) while the number of LDCs at high risk of debt distress increased to 16 and further increases are expected.[6]

Over the past decade also the composition of debt of LDCs changed considerably towards less concessional finance. An increasing number of mainly African LDCs issued one or more sovereign bonds between 2011 and 2019. These changes in the composition of debt also contributed to the increase in the debt-service burden (debt service relative to government revenue) of LDCs. Debt servicing costs for IDA-eligible countries, to which almost all LDCs belong, more than doubled between 2000 and 2019, increasing from 6 to 13 per cent of government revenue, which is often more than spending on health.

In 2020, debt service relief was provided to 26 LDCs by the IMF through the Catastrophe Containment and Relief Trust (CCRT). On April 15, the G20 announced the Debt Service Suspension Initiative (DSSI), which allows LDCs to suspend principal or interest payments on their debts to G20 and Paris Club members from May 2020 now through end of 2021. However, they will eventually have to pay the deferred principal and interest so this initiative mainly provides some breathing space. Eligible obligations account for around 40 per cent of LDC's total debt service obligations and 0.6 per cent of their GNI on average, indicating that the effect of DSSI will be limited. There have been numerous calls for the private sector to contribute to debt relief efforts to avoid that the resources made available by the DSSI initiative go to other creditors instead of being used for the COVID-19 response. However, activities in this respect were subdued.

---

[5] https://www.g20.org/wp-content/uploads/2021/04/Communique-Second-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting-7-April-2021.pdf

[6] https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf

Together with the Paris Club the G20 agreed in November 2020 on a “Common Framework for Debt Treatments beyond the DSSI” under which Chad, Ethiopia and Zambia have requested debt restructuring as of March 2021. However, this case by case approach is likely to involve lengthy debt restructuring processes.

It is clear that more long-term solutions are needed. The more comprehensive steps are taken now to reduce the debt burden and risk of defaults of LDCs the less need will be for bigger measures in the future. The prevention of debt crises needs to include strengthened debt management and enhanced debt transparency by creditors and debtors that would contribute to the promotion of responsible borrowing and lending.

An improved international debt architecture that benefits LDCs is needed. Sustainable solutions to the debt challenges of LDCs need to be explored, which could include debt-stock reductions and swifter debt-restructuring as well as state contingent loans and debt swaps. Technical assistance and capacity building for LDCs should be provided to strengthen their debt management.

Migration and remittances

COVID-19 affected international migration between LDCs and other countries through the rise in unemployment in host countries as well as via travel restrictions. The adverse effects of the crisis (loss of employment and income as well as exposure to COVID-19) have been especially severe for migrants. Protecting the lives and livelihoods of migrant workers will have positive effects in home and host countries as it will also ensure supply of critical goods and services and contribute to overall public health.

Remittance flows to LDCs had increased relatively rapidly from US$28.2 billion in 2011 to US$ 52.1 billion in 2019, which corresponds to around 5 per cent of GDP. According to World Bank estimates remittances to LDCs declined by 2 per cent from 2019 to 2020 and a further decline in 2021 is expected. Remittances inflows are concentrated in a few LDCs, with six countries (Bangladesh, Haiti, Myanmar, Nepal, Senegal, and Yemen) accounting for around 75 per cent of total remittance flows. For some smaller countries, remittances amounted to 20 per cent of GDP or more, including, Haiti, South Sudan, Nepal and Lesotho.[7]

The decline in remittances will not only reduce household income in recipient countries and thus increase poverty but also affect the private sector. Banks rely on remittance inflows as a cheap source of deposit funding since these flows are altruistically motivated. Due to the decline in remittances these banks are now likely to see their cost of operations increase, and their ability to extend credit will be greatly reduced. On the other hand, the COVID-19 pandemic has accelerated the usage and popularity of digital platforms of online money transfer and banking services.

While the recovery of remittances to LDCs will to a large extent depend on the recovery in migrant destination countries, especially labor market dynamics, LDCs and development partners can take some measures to improve the situation. For example, Governments in sending and receiving countries should incentivize the switch to and use of existing digital remittance products. Efforts to reduce the cost of remittances could include addressing regulatory and infrastructure barriers and enhanced domestic retail payment systems.

[7] World Bank (2020) Phase II: COVID-19 crisis through a migration lens, Migration and Development Brief 33, October 2020. (https://www.knomad.org/sites/default/files/2020-11/Migration%20%26%20Development_Brief%2033.pdf)

Graduation

Twenty LDCs have reached the graduation thresholds since the adoption of the IPoA in 2011, which represents important progress although short of the target of half the LDCs. Four countries have graduated since 2011, another four have been designated to graduate between now and 2024, while another twelve have met the graduation criteria at least once. However, the simultaneous loss of LDC support measures compounded by the negative economic impacts of the COVID-19 pandemic are a source of concern for those about to graduate. At its most recent session, the Committee for Development Policy (CDP) recommended a longer preparatory period of five years for the graduating LDCs as well as continuous monitoring of the pandemic impacts over the coming years and at the next CDP review in 2024. Support for their smooth transition by development and trading partners, as well as the UN system, will be essential to ensure that graduation is sustainable.[8]

The conditions to ensure that graduation leads to sustained economic growth and prosperity need to be explored further. These could include enhanced smooth transition measures, including an extension of trade preferences and the exemption from applying the TRIPs provisions for some time after graduation. Further incentives should be developed such as an enhanced programme of support to address the specific vulnerabilities of the graduating countries, including through private sector development and investment promotion and building of resilience. Enhanced coordinated UN support, for example through the inter-agency task force on least developed country graduation, has also been called for.

As currently almost all Asia-Pacific LDCs are in the graduation process, more focus needs to be put on the graduation challenges of African LDCs. These are closely related to their structural impediments like low human capital and high economic and environmental vulnerability, which need to be addressed throughout the new Programme of Action.

Guiding questions

- How can LDCs with support from their development partners increase government revenues, mobilize domestic savings for investment in sustainable development, and reduce inequalities?
- How can traditional and innovative sources of finance be enhanced to meet the funding gaps in LDCs in a predictable and effective manner?
- How can the increasing debt of LDCs be brought to sustainable levels and how can the international debt architecture be made more favourable for LDCs?
- How can remittances play a greater role in the development progress of LDCs?
- What international support measures (especially in the area of financing and trade) to graduating and graduated LDCs are needed to make graduation sustainable and irreversible?

[8] Report of the Committee for Development Policy (E/2021/33, Supplement No. 13)