2. Financing sustainable development in least developed countries

COVID-19 is having significant health and socio-economic impacts in least developed countries (LDCs) and is expected to cause major setbacks in these countries' already limited progress in achieving the Sustainable Development Goals (SDGs). This chapter provides an overview of the key financing challenges faced by LDCs, and outlines the economic and social impacts of and responses to COVID-19 in LDCs.

2.1. Least developed countries continue to face stark challenges across development and well-being dimensions

The United Nations defines LDCs as "low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets" (see Annex A for an overview of the criteria for the inclusion and graduation of LDCs) (UN/DESA, 2020[1])**.** There are 47 countries on the list of LDCs.[1] They are home to 1.03 billion people, about 14% of the world population, but with a combined GDP accounting for less than 1.3% of total global GDP (World Bank, 2019[2]).

The Istanbul Programme of Action (IPoA) for the LDCs, resulting from the Fourth United Nations Conference on the Least Developed Countries (LDC-IV), laid out the international community's strategy and vision to overcome the structural challenges faced by the LDCs for the 2011–2020 decade (UN, 2011[3])**.** The 2020 ministerial declaration of the LDCs calls for more blended finance to mobilise additional resources in LDCs (UN-OHRLLS, 2020[4]). The next Programme of Action is expected to result from the Fifth United Nations Conference on the Least Developed Countries (LDC5), scheduled for January 2022 in Doha. The 2030 Agenda recognised LDCs' specific challenges and vulnerabilities and set a number of LDC-specific targets, such as achieving at least 7% GDP growth per annum (SDG target 8.1) (UN, 2015[5]).

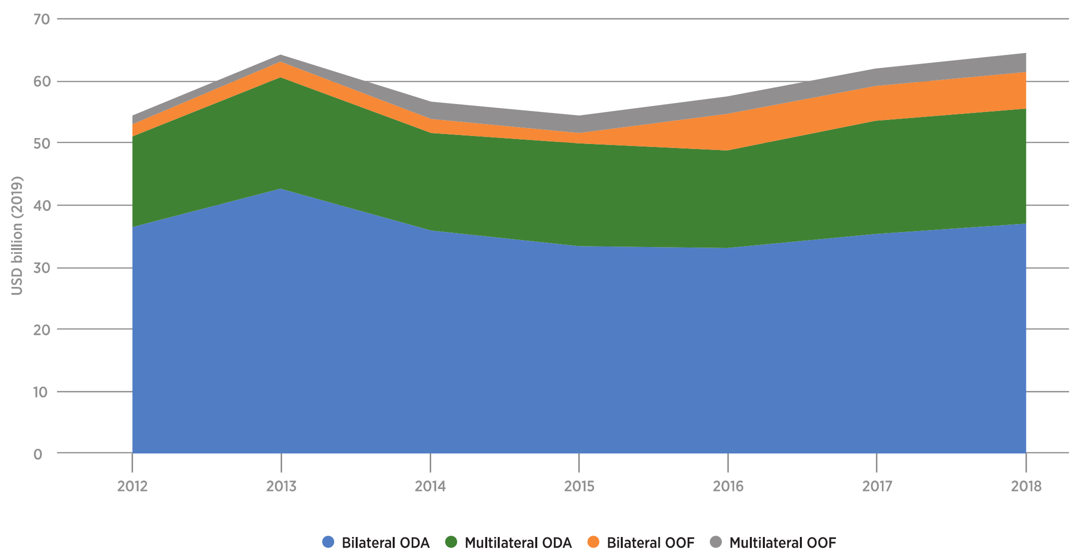
In the final year of the IPoA, evidence shows that despite significant progress in certain areas, LDCs still face structural impediments to eradicating poverty through economic growth, structural transformation, building productive capacity or increasing their share of exports (UN, 2020[6])**.** Most LDCs still experience significantly lower growth than the targets in the IPoA, well below the levels needed to eradicate extreme poverty by 2030. Beyond growth, the latest available data show significant differences between LDCs and other low-income countries across several human, social development, and economic and environmental sustainability dimensions. (See Annex B for an overview of the main gaps between LDCs and other developing countries.) Moreover, LDCs have been severely hit by the COVID-19 pandemic and the ensuing global economic downturn, exacerbating already existing vulnerabilities, as outlined in Sections 2.2 and 2.3.

2.2. Least developed countries faced severe SDG financing gaps even before the coronavirus (COVID-19) crisis

Although SDG financing challenges are common to all developing countries, LDCs face particular barriers. Financing investment through domestic resources is challenging for LDCs, which have low levels of income and domestic savings and often ineffective domestic resource mobilisation. Although tax revenues represent on average the largest source of financing for sustainable development in developing countries, they account for a much lower share of GDP in LDCs – 14.2% here, compared with 19.2% in low- to middle-income countries and 21.7% in upper-middle-income countries, as Figure B.1 in Annex B shows. LDCs rely to a large extent on external finance (i.e. development finance, remittances, and foreign direct investment (FDI), private investment and other investment – each having specific financing purposes), which represents a larger share of LDCs' GDP (16%) than domestic finance (14%).

Development finance is a critically important source of financing for LDCs. Looking specifically at official development finance trends, Figure 2.1 below shows that overall development finance to LDCs has been on an upward trend since 2015, with bilateral development finance largely exceeding multilateral. Official development assistance (ODA), which is provided on concessional terms,[2] largely dominates the official development finance landscape in LDCs. Preliminary data for 2019 suggest that, on a cash flow basis, net bilateral ODA flows to LDCs increased by 2.6% in real terms (OECD, 2020[7]). However, ODA provided to LDCs by DAC donors accounted for only 0.09% of the gross national income (GNI) of donor countries in 2018, well below their 0.15–0.20% ODA-to-GNI commitment[3] (see Annex B for details).

Figure 2.1. Official development finance to LDCs



Note: ODA: official development assistance; OOF: other official flows
Source: Authors, building on data collected for (OECD, 2020[7]), *Global Outlook on Financing for Sustainable Development*, https://dx.doi.org/10.1787/e3c30a9a-en.

Development finance providers should increase efforts to maintain ODA budgets and keep external financing flowing, including private investment and remittances, especially in LDCs (OECD, 2020[7])**.** In April 2020, DAC members issued a statement, committing to "strive to protect ODA budgets" (OECD DAC, 2020[8]).

DAC donors have also been increasingly leveraging scarce development finance resources to mobilise additional private finance for sustainable development in LDCs, through blended finance approaches. Chapter 4 provides a detailed overview on the latest trends of private finance mobilised in LDCs, building on OECD data. At the high-level meeting in November 2020, DAC members acknowledged the importance of ODA to respond to the COVID-19 crisis and promote long-term sustainable development, especially in LDCs. They also pledged to "continue working to find ways to mobilise more official and private resources for sustainable development, including promoting more – and more effective – blended finance, with special attention to LDCs" (OECD DAC, 2020[9]). It will be of utmost importance that DAC members implement these commitments.

2.3. Impacts of and responses to coronavirus (COVID-19) in least developed countries

Significant socio-economic impacts of the pandemic risk reversing the progress made in achieving the SDGs in LDCs. LDCs would have been better equipped to face and recover from the COVID-19 crisis had they been further advanced in meeting the SDGs and the Paris Agreement by the time of the crisis, including with stronger health systems, more resilient infrastructure and diverse economies, more gender equality, and better access to energy and digital services. Instead, the significant impacts of the pandemic now risk reversing any progress made in achieving the SDGs in LDCs.

2.3.1. COVID-19 health impacts are unfolding in LDCs at an uncertain yet alarming pace

While the spread of the coronavirus had a slow start in LDCs, it has accelerated, with a high incidence of imported cases (Bhattacharya and Islam, 2020[10]). LDCs had about 2.1% of the total global recorded cases and 1.3% of global recorded deaths as of October 2020 (EAPD/UNDESA, 2020[11]). However, there are concerns about serious under-reporting of cases and fatalities, due in part to the weak health systems and low testing capacities of LDCs (UN/DESA, 2020[12]).

While LDCs' young populations might be considered an advantage against the COVID-19 pandemic, **people in LDCs often have limited access to healthcare and lack basic water and sanitation facilities**, which are essential for hand hygiene and critical to preventing the spread of the virus (Bhattacharya and Islam, 2020[10]); (WHO, 2020[13]). COVID-19 is also hitting countries that are recovering from other epidemics, such as Ebola in West Africa (UN/OHRLLS, 2020[14]). Further, COVID-19 is likely to disrupt the delivery of other health services and the uptake of immunisation, especially in LDCs (UNICEF, 2020[15]).

Among LDCs, the extent of the health impact of the pandemic varies greatly. Bangladesh, the most populated LDC, has the highest number of reported cases. Moreover, while small island developing states reported a limited number of infections (due to their geographical remoteness), some LDCs with conflict or post-conflict status reported high numbers of confirmed cases. Further, overpopulated slums and refugee camps in LDCs are at high risk of uncontrollable COVID-19 outbreaks (Bhattacharya and Islam, 2020[10]).

2.3.2. The COVID-19 crisis is taking a heavy toll on LDCs' economies

The socio-economic impacts of COVID-19 in LDCs have been significant and risk reversing years of hard-won progress on sustainable development. Rapid and aggressive lockdown measures in most LDCs, including workplace closures, school closures and stay-at-home orders, have significantly reduced domestic demand and have forced businesses to shut down or to reduce operations. The real GDP growth rate for LDCs in 2020 is expected to plummet to 0.8%, down from 4.5% in 2018 and 4.8% in 2019 (UN, 2020[16]). The economic recovery is projected to be even slower than previously forecast (IMF, 2020[17]).

In addition to reduced domestic demand, the economic impact on LDCs is due in large part to the drastic contraction in global economic activity. Declining global demand, along with supply chain disruptions, is affecting LDCs' exports, particularly in textiles and garments. Disruptions in the tourism sector are heavily impacting small island LDCs. Many LDCs are also highly dependent on the natural resources sector (e.g. Angola's economy is heavily dependent on oil exports, Zambia's on copper exports), which is being negatively affected by a collapse in oil and commodity prices (UN-OHRLLS, 2020[18]).

The outlook for flows of FDI into LDCs in 2020 and beyond is also very weak. Globally, a drop in FDI by up to 40% is expected for 2020 (UNCTAD, 2020[19]). About a third of the total FDI investment in LDCs went to extractive industries, and, with sharply lower commodity prices caused by COVID-19, new FDI in the sector can be expected to be put on hold. FDI in other negatively affected export sectors such as tourism and textiles is also expected to suffer in the near to medium-term (UNCTAD, 2020[20]).

Flows of remittances, an important source of external finance for many LDCs, have dried up significantly as migrant workers from LDCs lose their jobs and return from host countries affected by the pandemic. While LDC-specific data are not yet available, projections indicate that remittances to sub-Saharan Africa and South Asia will fall by 23.1% and 22.1% respectively in 2020 as a result of COVID-19 (World Bank, 2020[21]).

In the short term, ODA will be critical to leverage additional finance in response to the crisis (OECD, 2020[22]). ODA has proven to be a key resource and countercyclical flow in past crises (OECD, 2020[23]). Given the unprecedented shock of the COVID-19 crisis, particularly in LDCs and fragile countries, ODA is likely to play an even more important role to prevent a rapid increase in extreme poverty and a reversal of the SDG progress in LDCs. Yet the global economic recession and declining public revenues risk putting downward pressure on ODA levels. Ultimately, how official development finance will evolve is still uncertain, and this remains a question of political will and global solidarity. As many ODA budgets for 2020 and 2021 had been finalised before the outbreak, the effect of the global economic recession on ODA levels might not be immediate but might show up later as a lagging indicator.

The COVID-19 crisis is further exacerbating the already high debt burden of LDCs. According to the World Bank Group-International Monetary Fund (IMF) debt sustainability framework, six LDCs were classified as debt distressed, with an additional one in external debt distress, and 16 LDCs faced a high risk of debt distress[4] (World Bank and IMF, 2020[24]). The composition of the debt stock of LDCs also changed significantly in the last decade, with an increasing share of debt held by private and non-traditional bilateral creditors (notably China). This is likely to pose challenges to creditor co-ordination (UN, 2020[6]). To rebuild their economies and mitigate social impacts, these countries will now have to increase their borrowing in the absence of other external support, as their already limited fiscal space will narrow further due to the crisis. While debt suspension efforts such as the debt service suspension initiative (DSSI), in which 29 LDCs participate,[5] are helpful in the short- to medium-term to address liquidity constraints, debt cancellation may be needed for the most vulnerable, highly indebted countries to avoid widespread defaults and to facilitate investments in recovery and the SDGs.

2.3.3. Other social impacts in LDCs due to COVID-19

The pandemic and ensuing crisis have created vast unemployment. In the second quarter of 2020, low-income countries registered a decline of 11% in the number of working hours, representing a 10.1% loss of labour income, in line with the global average of 10.7% loss of labour income (ILO, 2020[25]). In Bangladesh, for example, where garment manufacturing is the largest sector of employment, the workforce has been significantly affected as global demand has fallen and billions of dollars' worth of retail orders have been cancelled (Akiwumi, 2020[26]). The challenge of getting people back to work will be particularly difficult in LDCs, where high shares of the populations are self-employed and excluded from efforts to support the formal economy. Microfinance and support for financial intermediaries will remain important to reach informal workers. Moreover, many LDCs lack social protection systems to assist workers during times of crisis (UN/DESA, 2020[12]). More importantly, in low-income countries, the stimulus gap amounts to less than 1% of the total value of the above-the-line fiscal stimulus measures announced by high-income countries (ILO, 2020[25]). Support for the private sector will be essential not only to reduce job losses and preserve livelihoods but also to create new, high-quality and resilient jobs (EDFI, 2020[27]).

The crisis is having a disproportionately negative impact on women and girls, especially in fragile and conflict-affected contexts (OECD, 2020[28])**.** Girls and young women stand to be particularly affected by extreme poverty due to the COVID-19 crisis, according to the estimation of the United Nations Development Programme (UNDP) and the United Nations Entity for Gender Equality and the Empowerment of Women (UN Women) (Azcona, Bhatt and Kapto, 2020[29]). While sub-Saharan Africa is expected to continue being where most poor women live, Central and South Asia is expected to experience a resurgence in women's extreme poverty due to the pandemic (ibid.). There are signs that women are suffering increasingly from gender-based violence as a result of lockdowns and confinements, and that resources are being diverted from women's healthcare. Furthermore, there are indications that the pandemic will have long-term negative impacts on both women's employment and girls' participation in education (UN, 2020[30]).

Food insecurity is on the rise. The impact of the crisis on food systems, in combination with the effects of lost incomes, is pushing the world's poorest and most vulnerable people towards greater food insecurity. Globally, 135 million people faced acute food insecurity before COVID-19, and that number is expected to double to 270 million people in 2020, affecting poor and vulnerable people disproportionately (UN News, 2020[31]). Some 28% of the world's undernourished people live in LDCs (UN-OHRLLS, 2020[4]).

2.3.4. The responses, both domestic and international, in LDCs have been limited

To respond to the COVID-19 crisis, the United Nations Secretary-General has called for a global stimulus package that is a double-digit percentage of global GDP (UN, 2020[32]). The United Nations General Assembly also passed a resolution that called for a "comprehensive and co-ordinated response" to the pandemic. However, to date, there has been little appetite among the leading economies for a co-ordinated effort to support socio-economic stimulus in the LDCs. While the World Health Organization emergency appeal has been 93% funded at USD 1.6 billion, the humanitarian response plan of the United Nations Office for the Coordination of Humanitarian Affairs has been only 33% funded at USD 3.3 billion, of which some USD 1.45 billion is targeted specifically at 24 LDCs (UN Info, 2020[33]). The United Nations COVID-19 response and recovery fund has mobilised significantly less than anticipated.

The United Nations development system is working together to assess the socio-economic impacts of the COVID-19 pandemic on economies and communities, and has produced socio-economic impact assessments for some 33 of the 47 LDCs. It is also preparing response plans that include estimates of the investment needed (UNDP, 2020[34]). The United Nations development system repurposed some USD 2.9 billion of existing programming resources to support countries to respond to the crisis, of which an estimated USD 719 million was used across 33 of the LDCs (UN Info, 2020[33]).

The World Bank Group and the IMF have taken quick but relatively limited action. The IMF has an overall lending capacity of USD 1 trillion, but in response to the crisis it has so far lent only USD 280 billion, with USD 11 billion going to low-income countries (Goodman, 2020[35]). The International Development Association and the International Bank for Reconstruction and Development (IBRD) have, in the first seven months of 2020, increased total lending by 118% compared with the same period in 2019, although disbursements of funds are up only 31%. Compared with the global financial crisis in 2008–2009, this is less than half of the increase in monthly disbursements then (Duggan et al., 2020[36]). In low-income countries, loan disbursements have increased only slightly compared with last year, by about 0.33% of 2018 GDP. While this is a somewhat larger increase than low-income countries saw during the global financial crisis, the current crisis is significantly more severe for the poorest countries (ibid.). In March 2020, the International Finance Corporation designed a USD 8 billion fast-tracking financing response to provide immediate liquidity to its financial institutions and real sector clients to preserve jobs and prevent short-term damage. As of the end of October 2020, USD 4 billion had been committed under this first emergency response, of which close to half was expected to benefit people in the poorest countries and fragile states (IFC, 2020[37]). Furthermore, the World Bank Group is not participating in the G20 debt service suspension initiative, which offers, on request, the suspension of loan principal and interest payments from all official bilateral creditors to 73 low- and lower middle-income countries (Duggan et al., 2020[36]).

Several experts have also advocated that the IMF's special drawing rights (SDRs)[6] allocation be targeted to developing countries to support them to overcome liquidity shortfalls stemming from the COVID-19 crisis (Gallagher, Ocampo and Volz, 2020[38]); (Griffiths, 2020[39]); (Plant, 2020[40]); (ODI, 2020[41]); (UNCTAD, 2020[42]); (UN, 2020[43]). SDRs could be exchanged for hard currency for developing countries to bridge balance-of-payments financing gaps. However, SDRs can be allocated in proportion to members countries' IMF quotas, which are low for LDCs. The United Nations Conference on Trade and Development (UNCTAD) proposed that a new SDR allocation should go mostly or exclusively to developing countries (UNCTAD, 2020[44]). In March 2020, the IMF reported that it was considering the option of an SDR allocation to low- and middle-income countries with its members (IMF, 2020[45]). A USD 50 billion liquidity and sustainability facility for Africa has also been proposed by the United Nations Economic Commission for Africa (UNECA) and others, to lower borrowing costs by ensuring that short-term debt obligations can be met (UNECA, 2020[46]).

Finally, on 28 May 2020, **Canada, Jamaica and the United Nations Secretary-General convened a high-level event to join forces with heads of state and government, international organisations and other key partners to enable leaders to take the ambitious responses needed to address the COVID-19 pandemic.** As a follow-up to the event, a menu of policy options was prepared by six discussion groups convened to address questions of external finance and remittances; jobs and inclusive growth; recovering better for sustainability; global liquidity and financial stability; debt vulnerability; the engagement of private sector creditors; and illicit financial flows (UN, 2020[47]).

Domestically, the response to the crisis from most LDC governments has been limited and nowhere near the level of the unprecedented rescue packages provided in high-income economies. The average fiscal stimulus in low-income countries is estimated at 1% of GDP, according to the IMF (IMF, 2020[48]). Most LDC governments have provided some income or food support, though this is limited due to lack of social protection systems (UN/DESA, 2020[12]). Many LDCs have also developed support programmes that provide loans, guarantees or tax relief for affected firms, and income to workers. These measures, however, often fail to reach people in the informal economy, who are also the most vulnerable (ibid.). Some LDCs are providing relief by reducing transaction fees or increasing balance and transaction limits for mobile money payments and other digital financial services (ibid.). In addition, several LDCs are accelerating the implementation of e-government services online to keep procedures such as business registration available, to mitigate the impact on business and investors (UNCTAD, 2020[20]). Initial findings indicate that small and medium-sized enterprises (SMEs) in LDCs that were provided with some form of government support have stronger positive revenue outlooks and better operational capacity than those that were not supported. However, more than half of the SMEs surveyed indicated that they had not received any support (UNCDF et al., 2020[49]).

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Notes

[1] The 47 countries classified by the United Nations as LDCs are: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, the Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, the Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia. For more information, see http://unohrlls.org/about-ldcs.

[2] ODA mostly includes grant payments and, to a lesser extent, concessional loans (with a grant element of at least 25%), with the primary objective to promote economic development and welfare in recipient countries.

[3] LDCs have exclusive access to international support measures, including for development co-operation. Donors made a long-standing commitment to provide the equivalent of 0.15% to 0.20% of their GNI in the form of ODA to LDCs, reiterated in the Addis Ababa Action Agenda and included in SDG target 17.2 (more information is at https://www.un.org/ldcportal/commitments-regarding-oda-to-ldcs).

[4] The six LDCs in debt distress (overall and external debt) are Mozambique, Sao Tome and Principe, Somalia, South Sudan, the Sudan and Zimbabwe. The 16 LDCs in high risk of debt distress (overall and external debt) are Afghanistan, the Central African Republic, Chad, Djibouti, Ethiopia, the Gambia, Haiti, Kiribati, the Lao People's Democratic Republic, Liberia, Malawi, Mauritania, Sierra Leone, Togo, Tuvalu and Zambia (as of November 2020).

[5] As of November 2020 (World Bank, 2020[50]).

[6] The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. So far SDR 204.2 billion (equivalent to about USD 281 billion) have been

allocated to members, including SDR 182.6 billion allocated in 2009 in the wake of the global financial crisis. https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR