SETTING THE SCENE:
TRENDS IN DEVELOPMENT FINANCE, LDC GRADUATION AND AID FOR TRADE

Olivier Cattaneo, OECD, Development Cooperation Directorate

WTO webinar: « Implications of LDC graduation for Aid for Trade »
February 16th 2021
Content

• Development finance trends and challenges of LDC graduation
• How the COVID-19 crisis increases risks associated with LDC graduation
• Why we need to step-up our efforts on aid for trade
TRENDS AND CHALLENGES PRIOR TO THE COVID-19 CRISIS
Prior to the crisis (I): Picture of ODA to LDCs

- After a short decline in 2018, **aid to LDCs rebounded in 2019** to reach USD 32.8bn
- For the past two decades, **aid to LDCs grew twice as fast as aid to non-LDCs** (mainly 2000-10)
- Still, in 2019, DAC countries’ dedicated **0.09% of their GNI to LDCs** – still far from their commitment to dedicate 0.15% to 0.20% of their GNI

Source: OECD, CRS, 2020
Prior to the crisis (II): Aid for trade to LDCs

- The **share of LDCs in A4T is slightly larger** than its share of total aid (32% compared to 25%)
- **A4T has declined in recent years** after a decade of growth
- LDC graduation does **not** seem to significantly affect A4T allocation
- Change occurs at **UMIC** level – from infrastructure to productive capacity

Source: OECD, CRS, 2020
LDC graduation remains a difficult transition milestone

• LDC graduation transition finance **challenges:**
  - **High dependence on ODA** – risk of financing gap (quantity: in particular in social sectors) + financing trap (quality: grant element of ODA grants decreases by 45%)
  - **Difficulty to mobilize domestic resources and private finance** (only 6% of blended finance goes to LDCs)

Source: OECD, *Development finance toolkit, 2020*
HOW THE COVID-19 CRISIS INCREASES RISKS ASSOCIATED WITH LDC GRADUATION
Risk 1: Scissors effect and growing financing gap

- Graduating LDCs particularly affected because:
  - SIDS, LLDCs – travel (-68%) and transport (-24%) most hit by trade disruptions
  - Commodity prices – Angola, Equatorial Guinea (oil -20%)
  - GVCs – Bangladesh and textile/garment (-14.5% export earnings)

Source: OECD, Global Outlook on Financing for Sustainable Development, 2021
Against headwinds? ODA and stimulus packages

- **ODA** has a countercyclical role to play, but **3 scenarios**:
  - growth,
  - maintain nominal levels,
  - maintain % of GNI (drop by USD 14 bn – A4T -4.3 bn/46.5bn – **A4T to LDCs -1.3bn/14.2bn**)

- Graduating LDCs with limited (and expensive) access to capital markets cannot afford **stimulus packages**

Source: IMF, Fiscal Monitor, October 2020
The COVID-19 crisis acts as an **amplificator of debt challenges** faced by graduating LDCs.

**Explanation 1:** Surge of private debt

**Explanation 2:** Grants substituted by concessional loans

Not enough fiscal space to recover from crisis

- Covid-19 crisis could be the **debt crisis tipping point** for many countries
- **Fiscal space is not sufficient** to face the development challenges of graduating LDCs

---

**Zambia’s external debt stocks (USD billion)**

![Graph showing Zambia’s external debt stocks from 2000 to 2016.]

**High debt servicing costs left little fiscal room**

- **2014**: 36% Debt service, 12% Government wage bill, 52% Remaining resources
- **2015**: 38% Debt service, 15% Government wage bill, 47% Remaining resources
- **2016**: 32% Debt service, 19% Government wage bill, 49% Remaining resources
- **2017**: 24% Debt service, 25% Government wage bill, 51% Remaining resources
- **2018 Budget**: 22% Debt service, 31% Government wage bill, 47% Remaining resources
- **2019 Budget**: 13% Debt service, 45% Government wage bill, 42% Remaining resources

Risk 3: Diversion effect of stimulus and recovery packages in OECD countries

• **Stimulus and green recovery packages could divert even more resources from LDCs:**
  - Competing financing needs
  - Capacity to create a pipeline of bankable sustainable projects
  - Capacity to access green funds, navigate increasingly complex financing for development landscape (ex. more than 2,000 instruments to choose from)

• **Joint OECD-UNDP Framework for SDG-aligned Finance** proposes a number of actions:
  - **Technical assistance and capacity building** - global advisory pool mechanism for FfD in support of INFFs – e.g. how to repurpose debt (swaps, sustainability bonds, etc.)
  - “Revise aid for trade and increase related efforts to address post-COVID-19 crisis problems”

WE NEED TO STEP UP AID FOR TRADE EFFORTS
How this will affect access to A4T? The jury is still out

- **Risk of collapse v. opportunity**
  - 3rd scenario. UK from 0.7 to 0.5 but increased contribution to 2 A4T programs (Trade and Advocacy Fund, WB Trade Facilitation Support Program)
  - Multilateral development banks to step up (greater focus on SDGs 8 and 9)
- With 100M back into poverty and 300M jobs lost, we need to step up our efforts on A4T or a decade of progress towards SDGs might be lost
  - Make A4T a jobs agenda – not only volumes but quality of trade and investment
  - **Graduating or recently graduated LDCs are at high risk of set back** (closest to poverty line)
  - **Vicious circle**: less middle class, less trade and investment attractiveness; debt default, higher risk perception (i.e. higher interests rates, less finance and trade) – put back on higher reliance on ODA
A4T is part of the solution

- **Contain the crisis** – e.g. contain global value chains (GVCs) disruptions or FDI outflows through targeted support (e.g. use of innovative finance to de-risk trade and investment), or ensure continuous access to medical supplies (e.g. masks, ventilators) and future vaccines;

- **Mitigate the effects of the crisis** – e.g. provide temporary social protection of workers and safety nets in countries affected by the crisis, or preserve access to finance to suppliers in GVCs; and

- **Build back better** by increasing the qualities and resilience of GVCs – e.g. regional trade integration, upgrading of local production and infrastructure, promoting digitalization and services trade, promote transfers of technologies, knowledge and skills, regulatory reforms.
  - Ex. OECD FDI Qualities Toolkit and Companion Guidelines for donors
Annexes
The Transition Finance Toolkit is accessible from the United Nations LDC Portal

The OECD’s Transition Finance Toolkit

As LDCs approach graduation from the LDC category, they are often facing other simultaneous transitions related to development milestones such as reaching a certain level of income. Some of these affect their access to finance to a larger extent than LDC graduation. The OECD has developed a toolkit on transition finance, which seeks to provide countries with methodological guidance, evidence and assessment tools to implement a flexible approach to transition finance in their programmes.
Transition Finance Toolkit

Financing the journey to sustainable development

Throughout their journey towards sustainable development, countries face complex and evolving financing challenges. Donors thus need to constantly adapt their support to the changing financing needs of developing countries. The Transition Finance Toolkit provides them with the methodological guidance, evidence and assessment tools to implement a flexible approach to transition finance in their programmes. The content of the toolkit seeks to foster transparency and facilitate coordination among all development stakeholders.

The various dimensions of transition

The mix of financial resources accessible to developing countries varies over time. It depends on several, varying factors such as income levels, eligibility to specific financing instruments or support measures.

The transition finance fact sheets outline the key transition criteria and implications:

LDC Graduation

TRANSITION PROCESS

Year 0

Year 0-3

Year 3-3

Year 6

Graduation Criteria

Two of the three criteria must be met for two consecutive triennial reviews:

a. GNI per capita > LIC threshold (currently USD 1,330)

b. Human Asset Index (HAI) > 60

c. Economic Vulnerability Index (EVI) < 36

Alternatively a country can graduate when its GNI per capita is twice as high as the LIC threshold (currently USD 2,460).

TRANSITION IMPACT

External Financing Mix

RECENT & SCHEDULED GRADUATES

This section sheds light on each country's performance in attracting specific financing flows with respect to the overall trend or individual peer countries.

**Official Development Assistance (ODA)**

- Solomon Islands
- Vanuatu
- Samoa

**Other Official Flows (OOF)**

- Solomon Islands
- Vanuatu
- Samoa

**Foreign Direct Investment (FDI)**

**Remittances**

Data at this view is derived from OECD Creditor Reporting System (CRS) and World Bank's World Development Indicator (WDI).