



# 2

Managing fiscal space amidst multiple  
crises

# CHAPTER 2

## Managing fiscal space amidst multiple crises

<b>A. Introduction</b>	<b>15</b>
<b>B. The need for fiscal space in least developed countries in the context of multiple crises</b>	<b>15</b>
<b>C. The development finance landscape in the least developed countries</b>	<b>18</b>
1. The role of domestic resource mobilization	18
2. The role of external financial flows to least developed countries	22
3. How do official development assistance disbursements compare with commitments?	25
4. Composition of official development assistance flows to the least developed countries	26
5. The role of regional and subregional development banks	28
<b>D. Climate finance in the least developed countries</b>	<b>30</b>
1. The least developed countries and climate change	30
2. Climate finance flows to the least developed countries	31
3. The Loss and Damage Fund: A game changer for least developed countries?	35
<b>E. Summary and policy considerations</b>	<b>37</b>
<b>References</b>	<b>39</b>

## A. Introduction

Fiscal space refers to the extent to which a government can increase its spending or sustain a reduction in revenues without compromising its long-term fiscal or financial stability. In other words, it concerns the capacity of a government to implement its fiscal policy objectives while ensuring that its debt remains at a manageable level and its economy remains stable. In this sense, fiscal space is a crucial factor determining the resilience of the growth and development paths of the least developed countries (LDCs) in an increasingly complex and volatile global environment. This chapter highlights recent trends in key indicators of fiscal space, such as debt volumes and composition, as well as LDC governments' fiscal balances, and takes stock of the ability of LDCs to meet their development finance needs at a time when they are suffering from the impacts of numerous crises worldwide. It shows that external financial flows remain a critical factor for fiscal space in LDCs, while, over the medium term, domestic resource mobilization may play a larger role in some of these countries. Despite the critical role of external finance, official development assistance (ODA) flows to LDCs are substantially lower than commitments made by developed countries. In this regard, the chapter presents and discusses recent trends in ODA flows to the LDCs, including their volume, composition and target sectors.

*The Least Developed Countries Report 2022* (UNCTAD, 2022a) documented that, although the LDCs have contributed only marginally to the climate crisis, they are among the worst affected by climate change. They require more fiscal space for investments in adaptation and for expenditures to address climate-related loss and damage (L&D). This chapter reinforces this assessment by presenting the latest data on greenhouse gas (GHG) emissions and climate vulnerability. As countries' commitments fall far short of the target of the Paris Agreement to limit the rise in global temperatures to 1.5–2 degrees Celsius above pre-industrial levels (IPCC, 2022; WMO, 2023), LDCs need a surge in non-debt-generating climate finance. In this context, the chapter discusses recent trends in climate finance flows and the importance of the new Loss and Damage Fund for Vulnerable Countries agreed in 2022 at the twenty-seventh Conference of the Parties (COP27) to the United Nations Framework Convention on Climate Change (UNFCCC).

The analyses presented in this chapter all point in the same direction and illustrate a central message of this report: LDCs urgently need support to enhance their fiscal space. Without an increase in “fiscal breathing

**LDCs need greater support to reduce vulnerability to external shocks, enhance green transformation and achieve SDG progress**



space”, their mounting debt burdens and widening fiscal deficits threaten to divert their policy focus from their structural transformation agendas and undermine progress towards achieving the Sustainable Development Goals (SDGs). In this regard, the large gap between ODA flows to LDCs and SDG target 17.2 needs to be closed as quickly as possible,<sup>1</sup> largely in the form of an increase in grants, while ensuring that these are better aligned with national priorities. Non-debt-generating funding is what LDCs need now more than ever in order to safeguard their growth and development prospects. Furthermore, climate finance flows, including through the new Loss and Damage Fund, need to be scaled up substantially without adding to LDCs' debt burdens, increasing their transaction costs or posing a challenge to their institutional capacities.

## B. The need for fiscal space in least developed countries in the context of multiple crises

Fiscal space is an important factor in determining the growth and development prospects of LDCs. It is particularly important for LDCs in times of heightened economic stress, when governments need to respond quickly to crises or cope with a sudden shortfall in revenues. Economic downturns or recessions and

<sup>1</sup> Under Target 17.2, ODA providers are encouraged to consider setting a target to provide at least 0.20 per cent of ODA/GNI to LDCs.

natural disasters are examples of when fiscal space is necessary to provide fiscal stimulus, expand social spending to protect the well-being of the poor and vulnerable, fund humanitarian relief and undertake reconstruction of infrastructure. Furthermore, for LDCs that depend on commodity exports, a slump in commodity prices can cause a revenue shortfall that needs to be compensated. Similarly, for net-commodity-importing LDCs, price hikes for food, fuels and other essential commodities – as experienced in the context of the COVID-19 pandemic

and the war in Ukraine – can lead to mounting import bills (box 2.1), for which fiscal space can act as a buffer. LDCs also require fiscal space to enable their implementation of structural reforms and long-term investments aimed at building productive capacities.

There are various approaches to measuring fiscal space, each with its own data requirements, advantages and drawbacks (IMF, 2016; Cheng and Pitterle, 2018). However, ultimately, the fiscal space of LDC governments can be enhanced by generating

### Box 2.1 How commodity prices have affected fiscal space in the least developed countries

In the period 2019–2021, 35 of 46 LDCs were classified as commodity-dependent by UNCTAD, meaning that commodities accounted for more than 60 per cent of their merchandise export revenue (UNCTAD, 2023a). At the same time, the majority of LDCs are also net importers of basic commodities. For instance, in the period 2019–2021, 37 LDCs were net importers of fuels, 39 of basic food items and 44 of fertilizers;<sup>a</sup> and 31 LDCs were net importers of all three commodity groups. As a consequence, commodity price shocks and volatility can have an impact on fiscal space in LDCs through various channels. For net commodity exporters, particularly oil exporters, higher prices typically contribute to increased government revenue through taxes and royalties. However, commodity windfalls can also create pressure to increase government spending through subsidies, transfers and higher public sector wages. As a consequence, fiscal policy tends to be procyclical in oil-exporting developing countries (Erbil, 2011; Villafuerte and Lopez-Murphy, 2010), which can undermine long-term fiscal sustainability. For net importers of commodities, commodity price hikes can fuel inflation and increase the costs of social programmes and safety nets designed to protect the poor and vulnerable from rising prices, as they spend a disproportionately high share of their incomes on food and other basic goods.

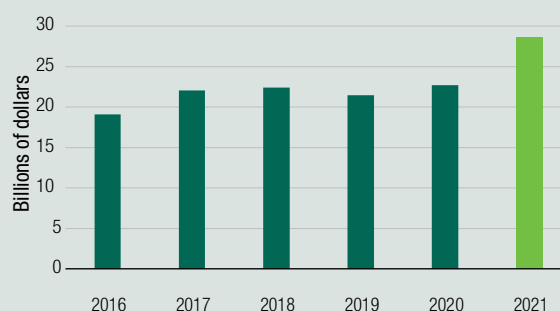
Commodity prices started on a broad-based upward trajectory in May 2020 following the initial COVID-19 shock that had caused a sudden drop in their prices. The rising trend persisted through mid-2022, with prices of several commodities, such as wheat and sunflower oil, reaching historic peak levels after the start of the war in Ukraine. As a consequence, net-commodity-importing LDCs saw a rise in their import bills for basic commodities. For instance, in 2021, the value of net imports of basic food to the LDCs as a group increased by 26 per cent on a year-on-year basis, equivalent to \$5.4 billion (box figure 2.1). This increase was equivalent to about 8 per cent of gross ODA disbursements to LDCs in 2021 (see section C.2). While food and fuel prices have moderated from their peak levels in 2022, they remain well above their pre-pandemic (2015–2019) average. In response to food and fuel price hikes, many governments, including in LDCs, announced new measures, in addition to existing subsidy schemes, to shield households and firms from the higher prices (Amaglobeli et al., 2023). For example, the IMF's Database of Energy and Food Price Actions (DEFFPA)<sup>b</sup> lists 97 measures announced in 27 LDCs. Of these, 41 implied increased government spending, such as for subsidies and in-kind or cash transfers; 38 measures affected government revenue, such as through the reduction of value-added taxes, excises or customs duties; and the remaining 18 measures aimed primarily to limit pass-through from international prices to domestic prices, such as price freezes and price caps.

A further source of fiscal stress for many net-commodity-importing LDCs was a depreciation of their currencies against the United States dollar. As the dollar is the main invoicing currency in international trade (Boz et al., 2022), in particular for commodities, this led to an increase in LDCs' import bills expressed in local currency, thereby exacerbating the effect of nominal price increases (UNCTAD, 2022b).

<sup>a</sup> UNCTAD secretariat calculations, based on UNCTADStat database. Fuels corresponds to Standard International Trade Classification (SITC) section 3; basic food to SITC sections 0 and 4 less division 07 and including division 22; and fertilizers to SITC group 562.

<sup>b</sup> Available at <https://www.imf.org/-/media/Files/Publications/WP/2023/Datasets/wp2374.ashx> [accessed 16 June 2023].

**Box figure 2.1**  
Net food import bill of the least developed countries, 2016–2021



Source: UNCTAD secretariat calculations, based on data from UNCTADStat (accessed 10 May 2023).

Notes: Food refers to basic food items excluding tea, coffee and spices.

higher revenue, increasing debt or receiving additional external grants.<sup>2</sup> As there are limits to scaling up domestic resource mobilization in the short run (see section C.1), LDCs, when faced with economic shocks or natural disasters, can effectively only rely on an increase in flows of external grants, over which they have no control, or resort to borrowing more. In this sense, key determinants of fiscal space in LDCs include the level and composition of debt, as well as the government's fiscal balance. Clearly, the higher the level of debt, the smaller the fiscal space, as the government will have limited capacity to borrow more without increasing its borrowing costs or risking a sovereign debt crisis. Also, a higher share of non-concessional debt on the government's balance sheet means higher costs for debt service, and thus less fiscal space going forward. Moreover, negative government fiscal balances can compromise debt sustainability, and thus limit their fiscal space over the medium term.

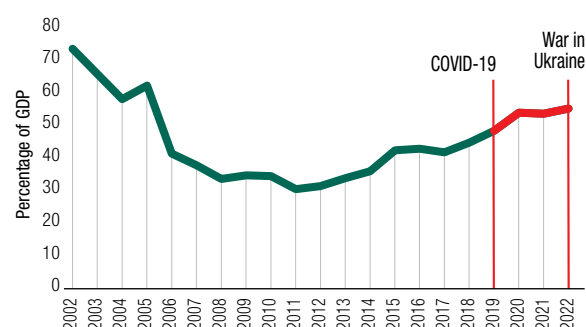
The COVID-19 pandemic triggered a deep economic crisis, which impacted global economic activity, international trade and financial conditions (IMF, 2020; United Nations, 2021). The LDCs have been particularly vulnerable to the global economic slowdown and widespread uncertainty, as they depend to a large extent on external financial flows to fund their development needs and structural transformation. The start of the war in Ukraine in early 2022 and the climate crisis have also negatively impacted fiscal and macroeconomic conditions in LDCs. As a consequence, the period 2020–2022 witnessed deterioration in the key indicators of their fiscal space. For instance, the median ratio of general government debt to gross domestic product (GDP) in LDCs increased from 48.5 per cent in 2019 to 55.4 per cent in 2022 (figure 2.1).<sup>3</sup> This is the highest level since 2005, after which these countries benefited from major debt relief through the Multilateral Debt Relief Initiative (MDRI) and the Heavily Indebted Poor Countries (HIPC) Initiative. In parallel, LDCs experienced a period of fast GDP growth, which lowered their median general government debt-to-GDP ratio to 30.6 per cent in 2011. The rise in government debt in the context of recent crises clearly points to a shrinking of LDCs' fiscal space. In this context, it is interesting to note that in 2021, the year between the initial shock of the COVID-19 pandemic in 2020 and the start of the war in Ukraine in 2022,

<sup>2</sup> In theory, also lowering expenditure can improve fiscal space, but in LDCs, the scope for spending cuts is limited given that the SDGs are underfunded as it is (UNCTAD, 2021) and the structural transformation agenda requires large investments.

<sup>3</sup> Also other debt sustainability indicators have worsened in the LDCs as demonstrated in chapter 3.

Figure 2.1

**General government debt in the least developed countries, 2002–2022**



Source: UNCTAD secretariat calculations, based on data from Kose et al., 2022.

Note: Median of 37 LDCs for which data were available for all the years during the period 2002–2022.

the median government debt-to-GDP ratio fell slightly, though it was still high. This suggests that LDCs are truly facing multiple crises, each with its own negative effects on their fiscal space.

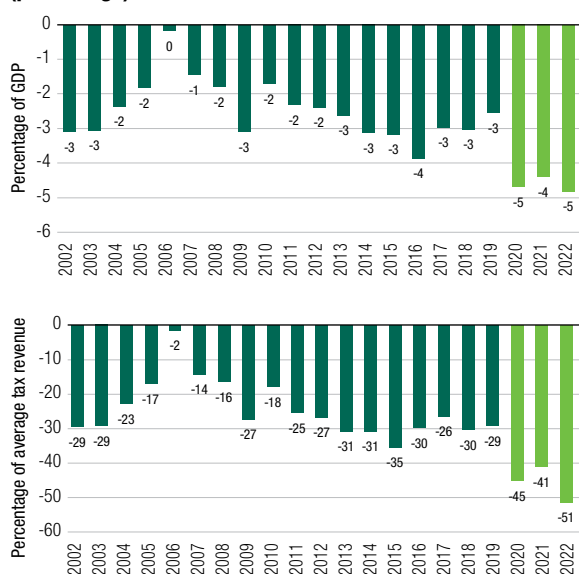
The impact of multiple crises has been particularly severe on LDCs' fiscal balances (figure 2.2) as they have faced pressure in particular on the expenditure side of government budgets. For instance, the average real government expenditure increased by 10 per cent from 2019 to 2020, while the median real government expenditure rose by 7 per cent.<sup>4</sup> High health spending due to the COVID-19 pandemic was a key driver of rising expenditures in LDCs, with average real central government health expenditure increasing by 27 per cent from 2019 to 2020 (or 23 per cent in the median LDC).<sup>5</sup> Also, the steep rise in commodity prices, including those of food and fuels, from mid-2020 to mid-2022 put an added strain on government budgets (box 2.1). As a result, during the period 2020–2022, the median LDC ran a fiscal deficit equivalent to 5 per cent of GDP and 46 per cent of tax revenues. This represents a major increase vis-à-vis the decade preceding the pandemic (2009–2019), when median deficits averaged 3 per cent of GDP and 28 per cent of tax revenue. Similar to government debt-to-GDP ratios, fiscal balances improved somewhat in 2021, but worsened markedly in 2022.

<sup>4</sup> UNCTAD secretariat calculations based on 42 LDCs for which data on government expenditure and GDP deflators were available in the IMF *World Economic Outlook* database (April 2023), available at <https://www.imf.org/en/Publications/WEO/weo-database/2023/April>. [accessed 1 June 2023].

<sup>5</sup> UNCTAD secretariat calculations, based on 40 LDCs for which data on central government health expenditure were available in the dataset provided in Kurowski et al., (2023); data for GDP deflators were available in the IMF *World Economic Outlook* database (April 2023).

Figure 2.2

Fiscal balances in the least developed countries, 2002–2022 (percentage)



Source: UNCTAD secretariat calculations, based on data from Kose et al., 2022.

Note: Median of 41 LDCs for which data were available for all the years during the period 2002–2022.

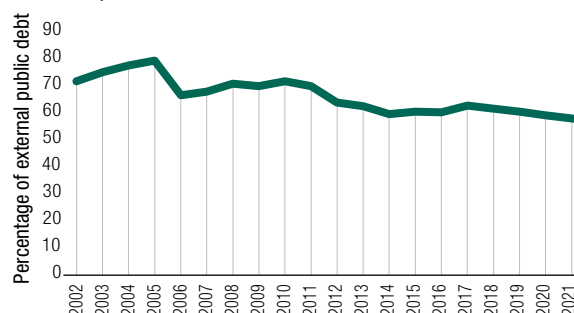
The composition of debt in the median LDC has followed an unfavourable trend since 2010 (figure 2.3), including during the period 2020–2021,<sup>6</sup> when LDCs needed more, not less, fiscal space. In 2021, the share of concessional loans in total external public debt was 57 per cent in the median LDC, which represented a 2 percentage point decline from 2019 and a staggering 14 percentage point decline from 2010. As a consequence of the lower shares of concessional debt, borrowing costs for LDCs have increased (DESA, 2021). Also, the evolution in the composition of their external debt points to a shrinking fiscal space in the LDCs, as do trends in other indicators linked to fiscal space, such as debt service payments (see chapter 3).

In conclusion, the evolution of key fiscal indicators shows that fiscal space in many LDCs had been shrinking even before the COVID-19 crisis. The pandemic increased the pressure on government spending and public debt, leaving LDCs with the prospect of weak domestic recovery and greater scarring effects on the economy (UNCTAD, 2021). Going forward, geopolitical risks and uncertainties continue to weigh heavily on global growth, which is expected to decelerate to 2.1 per cent in 2023 (UNCTAD, 2023b; World Bank, 2023). Hence, it is important that, over the medium term, fiscal policy

<sup>6</sup> Data for 2022 were not available at the time of writing this report.

Figure 2.3

Concessional external debt stocks in the least developed countries, 2002–2021



Source: UNCTAD secretariat calculations, based on data from Kose et al., 2022.

Note: Median of 41 LDCs for which data were available for all the years in the period 2002–2021.

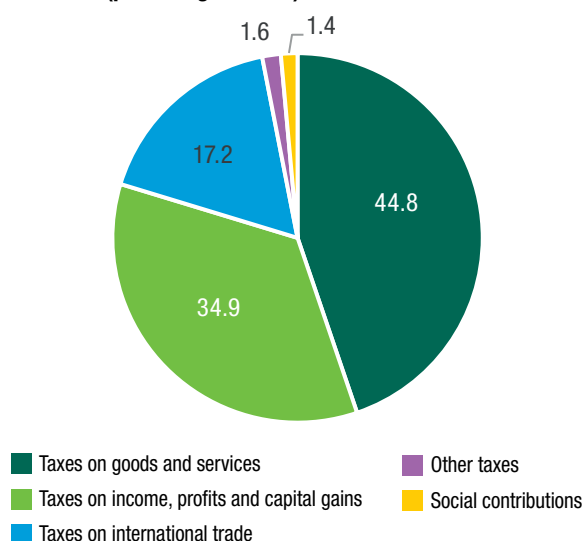
frameworks in LDCs become more resilient to shocks and volatility emanating from global economic conditions, geopolitical crises and commodity price fluctuations. However, in the short to medium term, LDCs need the support of their development partners to enlarge their fiscal space, as discussed in the next section.

## C. The development finance landscape in the least developed countries

### 1. The role of domestic resource mobilization

Domestic resource mobilization (i.e. the ability of a government to generate financial resources from within its own economy), is a vital factor for maintaining fiscal space and overall economic resilience. While external finance plays a major role in financing the SDGs, it is crucial for a country to increase its own domestic resources by strengthening the scope and efficiency of domestic resource mobilization. In particular, an effective and equitable tax system can generate stable and sustainable revenue flows. Taxes on goods and services, which include value added taxes, account for the largest share of domestic revenue in total government revenue in LDCs, with an average share of 44.8 per cent, followed by taxes on incomes, profits and capital gains (34.9 per cent) and taxes on international trade (17.2 per cent) (figure 2.4). For some LDCs, trade taxes are the largest source of domestic revenue. Among the 27 LDCs for which data since 2015 were available, these include Solomon Islands and Somalia. Taxes on income, profits and capital gains accounted for

**Figure 2.4**  
Composition of government revenue in least developed countries (percentage of total)

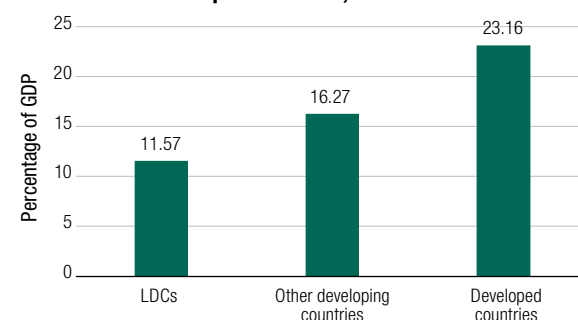


Source: UNCTAD secretariat calculations, based on data for 27 LDCs from the World Bank's *World Development Indicators* database (accessed 28 June 2023).  
Note: Data reflect group averages for the latest year available since 2015.

the largest share of government revenue in Angola, Bhutan, Malawi, Timor-Leste and Zambia.

LDCs as a group lag behind other country groups in terms of tax revenues collected as a share of GDP (figure 2.5). However, there are some LDCs where tax revenue-to-GDP ratios are comparable to those of more advanced countries. These include resource-rich economies, such as Angola and Mozambique, and

**Figure 2.5**  
Tax revenues as a percentage of gross domestic product in least developed countries, compared with other developing countries and developed countries, 2020

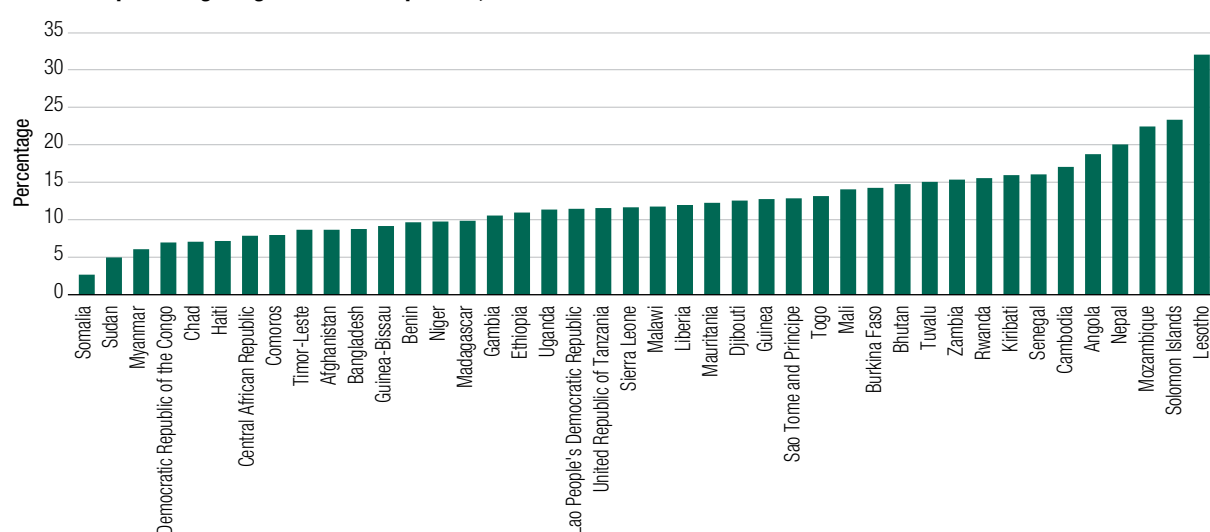


Source: UNCTAD secretariat calculations, based on data from UNU-WIDER, 2022.  
Note: Tax revenues exclude social contributions. The figure shows group medians. Data for 31 LDCs were available for 2020. Data for the Central African Republic was sourced from the World Bank, *World Development Indicators* database (accessed 10 May 2023).

small island developing States (SIDS) such as Kiribati and Solomon Islands (figure 2.6). In Lesotho, where the average tax revenue-to-GDP ratio in 2016–2020 was largest among the LDCs for which data were available, transfers from the Southern African Customs Union (SACU) played an important but volatile and declining role (IMF, 2022).

There are several means to improving domestic resource mobilization in LDCs, through policy, institutional and capacity-building measures. While the specific priorities may vary based on the unique circumstances and challenges faced by each LDC, there is generally

**Figure 2.6**  
Taxes as a percentage of gross domestic product, 2016–2021



Source: UNCTAD secretariat calculations, based on data from UNU-WIDER, 2022.  
Note: The data for taxes excludes social contributions, and represent averages of all available years for the period 2016–2021. Data for the Central African Republic were sourced from the World Bank, *World Development Indicators* database (accessed 10 May 2023). No data for the period 2016–2020 were available for Burundi, Eritrea, South Sudan and Yemen.

## Domestic resource mobilization is vital for increasing the fiscal space and overall economic resilience of LDCs

scope for strengthening the domestic tax system by broadening the tax base, reducing tax evasion and aggressive tax avoidance, improving tax administration and enhancing tax compliance.

For example, many LDCs have large informal sectors that operate outside the reach of the tax system. The informal economy in LDCs accounted for an estimated average share of 35–40 per cent of GDP in 2018,<sup>7</sup> and for 86 per cent of total employment during the period 2019–2021.<sup>8</sup> Pervasive informality has been shown to be associated with both lower government revenues and expenditures (Ohnsorge and Yu, 2022). As reported in *The Least Developed Countries Report 2018* (UNCTAD, 2018), a large proportion of informal entrepreneurs in LDCs would like to register their businesses but fail to do so due to administrative obstacles, costs or a lack of information. Therefore, encouraging informal businesses to register and become part of the formal economy could help broaden the tax base. This could be achieved through simplified business registration and tax payment procedures, providing incentives for formalization and offering support services to informal businesses.

Also, reviewing and reducing tax exemptions or preferential treatment for specific sectors or entities could broaden the tax base and ensure a more equitable distribution of the tax burden in LDCs. Exemptions that are not justified by public interest objectives should be phased out. Furthermore, introducing or expanding the coverage of a value added tax could help broaden the tax base by capturing revenue from a broader base of economic activities. Additionally, implementing progressive income taxes and enforcing compliance among high-income earners could contribute to broadening the tax base and ensuring a fairer tax system. In an effort to attract foreign direct investment (FDI) and businesses, many LDCs have lowered their tax rates and provided a range of tax incentives such as tax holidays or incentives to firms operating in special

economic zones (UNCTAD, 2022c). For instance, the average corporate income tax rate in LDCs fell from 35 per cent in 2000 to 28 per cent in 2022.<sup>9</sup>

Domestic resources in LDCs could also be increased by clamping down on illicit financial flows (IFFs). Such flows drain many LDC economies of scarce financial resources, and therefore constitute an obstacle to the achievement of the SDGs. For example, illicit capital flight from Africa was estimated at \$89 billion annually, on average, during the period 2013–2015 (UNCTAD, 2020); and during the period 2002–2018, estimated capital flight from the 15 African LDCs for which data were available amounted to \$521 billion (Ndikumana and Boyce, 2021).<sup>10</sup> Tax evasion and aggressive tax avoidance practices include the manipulation of transfer prices (i.e. the mispricing of goods, services and intellectual property between related business entities). In particular, multinational enterprises (MNEs) often resort to transfer mispricing of cross-border transactions among their entities in order to reduce their tax base by artificially shifting profits from high-tax jurisdictions to low-tax jurisdictions. Also, some MNEs use financial mechanisms, such as loans from offshore-based entities and associated debt service payments, to reduce their tax bills (UNCTAD, 2015a). Therefore, strengthening transfer pricing regulations and enforcement mechanisms could prevent profit shifting and ensure that MNEs operating in LDCs pay their fair share of taxes.

In this regard, international cooperation plays a crucial role. For example, the Organisation for Economic Co-operation and Development (OECD)/Group of 20 project on Base Erosion and Profit Shifting (BEPS) aims at improving international tax coordination to combat tax avoidance by MNEs. By 9 June 2023, there were 12 LDCs among the 143 Members of the OECD/Group of 20 Inclusive Framework on BEPS.<sup>11</sup> International cooperation also plays a key role in combating tax avoidance and evasion by fostering information exchange and transparency. Existing initiatives include the Global Forum on Transparency and Exchange of Information for Tax Purposes, which counted 20 LDCs among its 167 members

<sup>7</sup> UNCTAD secretariat calculations, based on data for 38 LDCs for which data were available in the World Bank's Informal Economy database (Elgin et al., 2021).

<sup>8</sup> UNCTAD secretariat calculations, based on data for 17 LDCs for which data were available for SDG indicator 8.3.1 in the United Nations *SDG Indicators* database (average of latest available year).

<sup>9</sup> UNCTAD secretariat calculations, based on data from the Tax Foundation, available at: <https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/> (accessed 28 June 2023).

<sup>10</sup> UNCTAD secretariat calculations, based on constant 2018 dollars in the Excel file accompanying Ndikumana and Boyce, 2021. Available at [https://peri.umass.edu/images/Capital\\_flight\\_from\\_African\\_countries\\_1970-2018\\_-\\_May\\_2021.xlsx](https://peri.umass.edu/images/Capital_flight_from_African_countries_1970-2018_-_May_2021.xlsx) (accessed 21 June 2023).

<sup>11</sup> The BEPS membership list is available at <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf> (accessed 15 June 2023).



as of May 2023.<sup>12</sup> Development partners can also strengthen domestic resource mobilization in LDCs by supporting efforts to combat IFFs through capacity-building and technical assistance, in line with SDG target 16.4.<sup>13</sup> For instance, the Addis Tax Initiative (ATI), a multistakeholder partnership that supports domestic resource mobilization in developing countries, also includes many LDCs.<sup>14</sup> Ongoing work to strengthen the methodological basis for measuring IFFs and building statistical capacity is also an important element in the fight against IFFs.<sup>15</sup>

There may also be scope for green tax reforms in some LDCs, including by reducing harmful fossil fuel subsidies, which can be costly, distortive and regressive (Coady et al., 2015). For instance, in 2020, energy subsidies alone were in the range of \$7.8 billion–\$11.6 billion in LDCs.<sup>16,17</sup> However, reforming inefficient fossil fuel subsidies in line with SDG 12 requires a gradual approach, broad consideration of socioeconomic effects and the careful design of targeted measures to ensure that poor and vulnerable groups are not made worse off. In particular, the design of fossil fuel subsidy reforms should include targeted safeguards that protect progress towards SDG 7 (ensuring access to affordable, reliable, sustainable and modern energy for all).

In resource-rich LDCs, better management of natural resources through transparent and accountable governance frameworks and favourable contracts with enterprises in the extractive industries could further contribute to domestic resource mobilization. In particular, imposing appropriate taxes, royalties and fees on resource extraction is critical. In this context, the global energy transition presents an opportunity for LDCs that have reserves of critical minerals

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## The global energy transition presents an opportunity for LDCs that have reserves of critical minerals

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used in the production of low-carbon technologies, such as bauxite, cobalt, copper, graphite and rare earth elements (UNCTAD, 2022a). For instance, the Democratic Republic of the Congo has the world's largest reserves of cobalt, accounting for an estimated 68 per cent of global mine output in 2022 (United States Geological Survey, 2023). Guinea has the world's largest reserves of bauxite and was the second largest mine producer in 2022 (United States Geological Survey, 2023). Madagascar and Mozambique jointly account for 15 per cent of global natural graphite reserves, and produced 22 per cent of global mine output in 2022 (United States Geological Survey, 2023). Rare earth reserves exist in Burundi, Madagascar, Myanmar and the United Republic of Tanzania (United States Geological Survey, 2023). Furthermore, the Democratic Republic of the Congo and Zambia hold large copper reserves (United States Geological Survey, 2023).

Global demand for these critical minerals is bound to significantly increase with the rising demand for electric vehicles and renewable energy generation. For example, the International Energy Agency estimates that the energy transition needed in order to reach the goals of the Paris Agreement would increase demand for cobalt and graphite by factors of 21 and 25, respectively, from 2020 to 2040 (IEA, 2022). Large-scale support schemes to promote green technologies in developed countries, such as under the Inflation Reduction Act in the United States, which includes tax breaks and subsidies worth \$369 billion (United States Department of the Treasury, 2022), and the European Green Deal Industrial Plan for the Net-Zero Age (European Commission, 2023), are likely to drive significant demand growth for critical minerals in the short term. In this context, domestic financial resources in LDCs can be increased by promoting local value addition in the extractive industry. The recent announcement of collaboration between the Democratic Republic of the Congo and Zambia to jointly develop an industry for producing battery precursor materials is a promising initiative in this regard.<sup>18</sup>

<sup>12</sup> See <https://www.oecd.org/tax/transparency/who-we-are/members/> (accessed 22 June 2023).

<sup>13</sup> SDG target 16.4 aims to “significantly reduce illicit financial and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organized crime”.

<sup>14</sup> See <https://www.addistaxinitiative.net/> (accessed 24 July 2023).

<sup>15</sup> See, for example, recent UNCTAD-supported progress in producing official statistics on IFFs, at: <https://unctad.org/news/first-ever-official-data-illicit-financial-flows-now-available> (accessed 21 June 2023).

<sup>16</sup> UNCTAD secretariat calculations, based on UNEP, retrieved from *SDG Indicators* database (lower bound) and the IMF, Energy Subsidy Template, available at <https://www.imf.org/en/Topics/climate-change/energy-subsidies>, (upper bound of estimate) (both accessed 23 May 2023).

<sup>17</sup> Explicit subsidies reflect undercharging for supply costs and producer subsidies. However, the bulk of energy subsidies are implicit, which reflect undercharging for environmental costs and general consumption taxes. There are different ways of calculating explicit subsidies (see UNEP, 2019 and Parry et al., 2021) for methodological notes).

<sup>18</sup> See <https://www.un.org/africarenewal/magazine/may-2022/trade-ties-zambia-and-drc-sign-cooperation-agreement-manufacture-electric>.

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## Official development assistance remains the largest source of external finance for LDCs

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Combating corruption and improving governance are also crucial for creating an enabling environment for domestic resource mobilization. Strengthening institutions, promoting transparency, and implementing effective anti-corruption measures can help to ensure that resources are used for public benefit. The Extractive Industry Transparency Initiative (EITI) is an example of an international initiative that can help promote transparency and accountability in the oil, gas and mining sector, and thereby ensure a more equitable distribution of revenues from the exploitation of countries' natural resources. As of June 2023, 24 LDCs were members of the EITI, and five LDCs were classified as making high or very high progress in meeting EITI standards for validation.<sup>19</sup> Furthermore, effective public financial management systems can help optimize the allocation and utilization of public resources. Strengthening budgetary processes, implementing transparent procurement systems, and enhancing financial reporting and auditing mechanisms could improve the efficiency and effectiveness of resource mobilization and expenditure.

Many LDCs have underdeveloped financial systems, resulting in low savings rates and limited access to capital. Development of their financial sector could play a crucial role in facilitating domestic resource mobilization. A well-functioning financial sector promotes savings and investment by providing efficient and inclusive financial services, such as savings accounts, insurance and pension schemes. This encourages individuals and businesses to save and invest their incomes, thereby creating a pool of funds that can be put to productive use within the country. Importantly, it facilitates access to credit. In many LDCs, access to affordable and formal credit sources is often lacking, which inhibits entrepreneurial activities and productive investments. By establishing robust banking systems, microfinance institutions and credit guarantee schemes, LDCs can enable businesses, especially small and medium-sized enterprises (SMEs), to access credit for expansion and innovation, leading to increased domestic resource

mobilization. Furthermore, a well-developed financial sector can promote the development of capital markets; stock exchanges, bond markets and venture capital networks allow businesses to raise funds from domestic investors. This reduces reliance on external sources of financing and promotes the retention of domestic resources within the country. Finally, financial sector development enhances financial inclusion by reaching and empowering marginalized populations. By facilitating access to financial services, LDCs can bring the unbanked population into the formal financial system, enabling them to save, invest and participate in economic activities. This inclusion leads to a broader resource base and more robust domestic resource mobilization. Chapter 4 provides an analysis of the state of financial sector development in LDCs, and of the role that net-zero banking could play in their sustainable development.

Overall, the role of domestic resource mobilization in LDCs can only grow in parallel with the implementation of LDCs' structural transformation agendas, the build-up of productive capacities and increased efforts to strengthen governance, improve tax systems and enhance institutional capacity at both national and international levels. The impact of domestic resource mobilization and allocation can be improved by better aligning the focus of ODA flows with domestic priorities and processes in LDCs (see next section). In this context, LDC governments and ODA providers should seek to maximize complementarity and create synergies between aid and domestic resource allocation, while reducing overlaps and wasteful spending through parallel processes. This includes using national systems and processes to deliver ODA wherever it is most needed or where it would have the most beneficial effects in line with national priorities.

## 2. The role of external financial flows to least developed countries

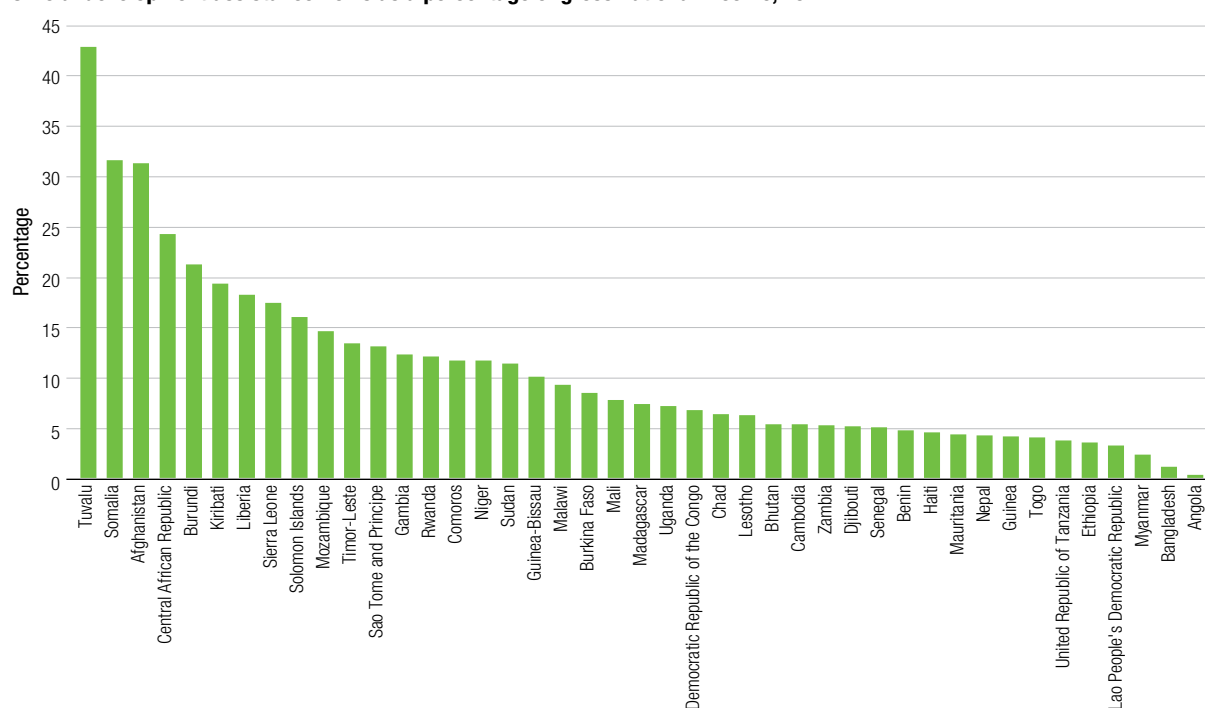
The landscape of external financial flows for development in LDCs is complex and multifaceted, involving a variety of different actors and funding sources. Overall, ODA continues to be the largest source of external finance to LDCs, ahead of remittances, FDI and other official flows (OOF) (see chapter 1). For LDCs as a group, ODA inflows relative to key macroeconomic variables declined in 2021 after marked increases in 2020, when development partners scaled up their support in response to the COVID-19 pandemic (figure 2.7). Net ODA received as a share of LDCs' gross national income (GNI) in 2021 stood at 4.8 per cent, down from 5.5 per cent in 2020 and close to its pre-pandemic level of 4.6 per cent in 2019. Similarly, net ODA received as a share

<sup>19</sup> See EITI website at: <https://eiti.org/countries> (accessed 16 June 2023). The five countries classified as making high or very high progress are the Democratic Republic of the Congo, Guinea, Senegal, Sierra Leone and Zambia.

of imported goods, services and primary income fell from 19.6 per cent in 2020 to 14.3 per cent in 2021, slightly below the 14.5 per cent registered in 2019. Net ODA received as a share of gross capital formation also fell in 2021, but remained slightly above its 2019 level. Per capita ODA in current dollars reached an all-time high of \$60 in 2020, but fell to \$55 in 2021. Overall, the weight of ODA relative to GNI, imports and investment, as well as per capita ODA flows to LDCs, increased from 2017 to 2021. In other words, the dependence on ODA by LDCs as a group is on the rise. However, aggregate figures mask huge disparities of ODA dependence across LDCs (figure 2.8). At the upper end of the spectrum is Tuvalu, where the share of ODA in GNI was 42.8 per cent in 2021, while at the lower end, Angola received only a 0.4 per cent share in GNI.

Figure 2.8

### Official development assistance flows as a percentage of gross national income, 2021



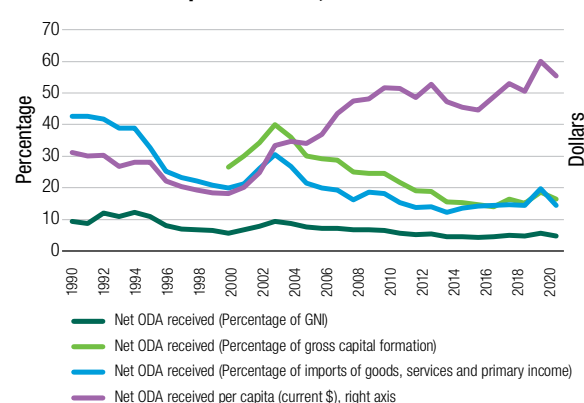
Source: UNCTAD secretariat calculations, based on data from the World Bank, *World Development Indicators* database (accessed 8 May 2023).  
Note: Data were not available for Eritrea, South Sudan or Yemen.

The 46 LDCs jointly received \$73.7 billion in gross disbursements of total official flows in 2021, of which the bulk (\$66.9 billion, or 90.7 per cent) was ODA and a minor but growing share (\$6.8 billion, or 9.3 per cent) was OOF (figure 2.9).<sup>20</sup> ODA flows to LDCs reached a record high of \$72.9 billion in 2020, the year the COVID-19 pandemic

<sup>20</sup> Data for ODA in figure 2.9 differ somewhat from figure 2.7 because the amounts in figure 2.7 are expressed in current dollars.

Figure 2.7

### Selected indicators of official development assistance flows to the least developed countries, 1990–2021



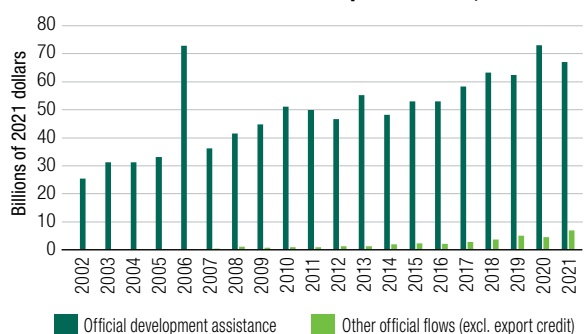
Source: UNCTAD secretariat calculations, based on data from the World Bank, *World Development Indicators* database (accessed 8 May 2023).

started. In the period 2019–2021, ODA flows to LDCs totalled \$202 billion, of which the five largest recipients – Bangladesh, Ethiopia, Afghanistan, Yemen and the Democratic Republic of the Congo – received 35 per cent (figure 2.10).

Bilateral flows from member countries of the OECD Development Assistance Committee (DAC) and multilateral flows constitute the bulk of ODA flows to LDCs (figure 2.11). Non-DAC official bilateral ODA flows accounted for 3.8 per cent of total ODA

Figure 2.9

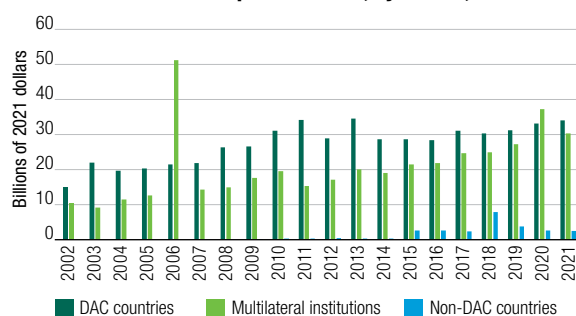
**Gross disbursements of official development assistance and other official flows to the least developed countries, 2002–2021**



Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 23 May 2023).

Figure 2.11

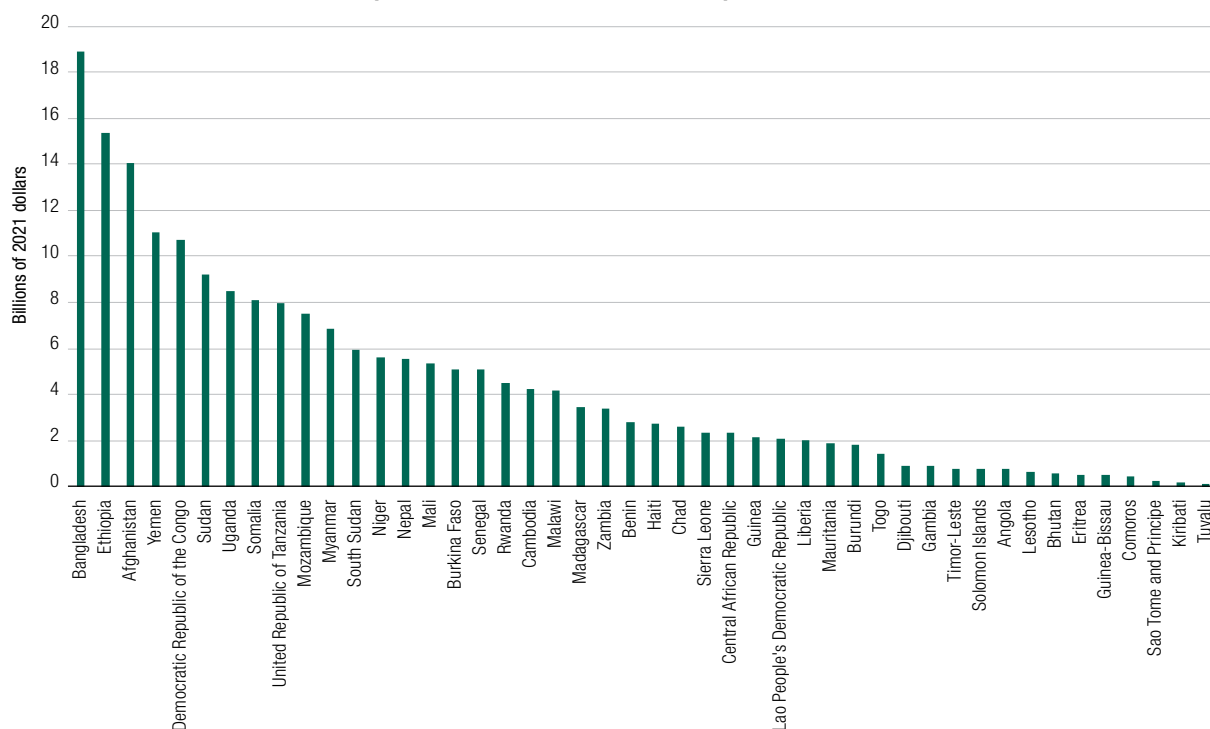
**Gross disbursements of official development assistance flows to the least developed countries, by source, 2002–2021**



Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 23 May 2023).

Figure 2.10

**Gross disbursements of official development assistance to the least developed countries, 2019–2021**



Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 23 May 2023).

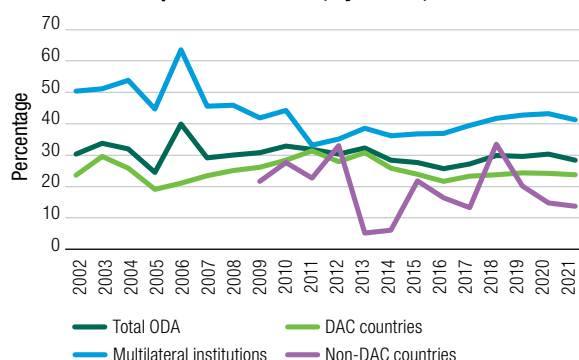
in 2021. However, since not all countries report to the OECD *Creditor Reporting System*, notably China and India, non-DAC bilateral flows to LDCs are likely underestimated by a significant margin.<sup>21</sup> In 2020,

multilateral ODA flows exceeded bilateral flows for the first time since 2006 when major multilateral debt cancellations took place within the framework of the Multilateral Debt Relief Initiative.

The share of LDCs in total ODA flows to developing countries was 28 per cent in 2021, down 2 percentage points from 2020 (figure 2.12). There was a significant gap between the share of LDCs in ODA provided bilaterally by DAC countries and multilaterally during the period 2002–2021. In 2021 that share was 24 per cent from DAC countries and 41 per cent from multilateral institutions.

<sup>21</sup> For instance, estimates of China's bilateral official flows differ, as varying definitions are used in the literature. The Japan International Cooperation Agency estimates Chinese flows in 2019 to have been \$5.9 billion, which would make China the sixth largest source of bilateral flows in that year (Kitano and Miyabayashi, 2020). And the OECD estimates that bilateral flows from India amounted to \$1.01 billion in 2020 (OECD, 2023a).

**Figure 2.12**  
Share of the least developed countries in gross disbursements of official development assistance, by source, 2002–2021

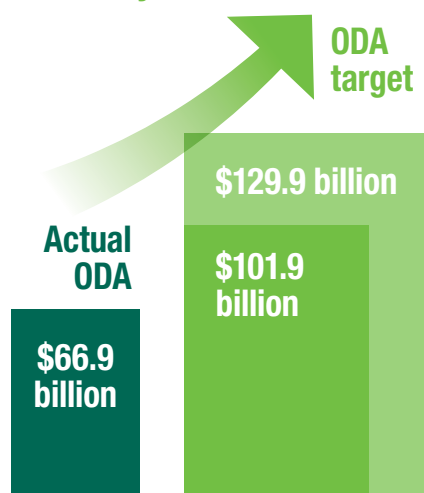


Source: UNCTAD secretariat calculations, based on data from the OECD Creditor Reporting System database (accessed 13 June 2023).

### 3. How do official development assistance disbursements compare with commitments?

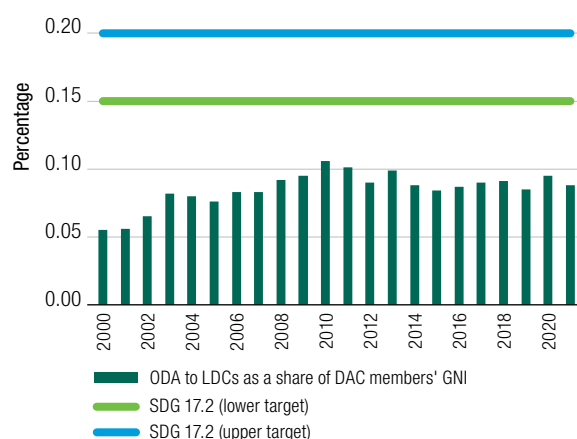
SDG Target 17.2 calls on developed countries to “Implement fully their official development assistance commitments, including the commitment by many developed countries to achieve the target of 0.7 per cent of gross national income for official development assistance (ODA/GNI) to developing countries and 0.15 to 0.20 per cent of ODA/GNI to least developed countries; ODA providers are encouraged to consider setting a target to provide at least 0.20 per cent of ODA/GNI to least developed countries.” The target of 0.15–0.20 per cent of GNI was subsequently also included in the Doha Programme of Action (DPoA) (United Nations, 2022: para.250).

### Meeting the ODA target would boost aid to LDCs by \$35 billion–\$63 billion



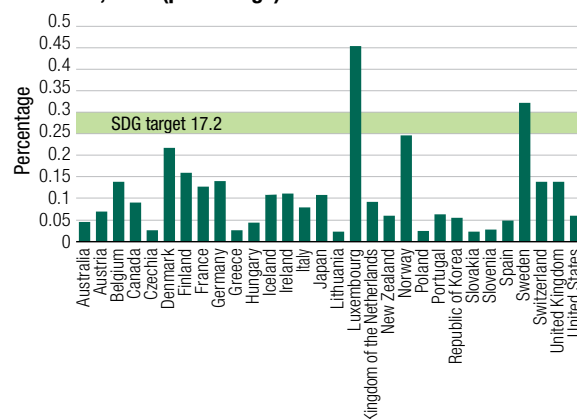
ODA flows to LDCs have been consistently lower than the commitments made by the developed countries. Latest figures show that in 2021, ODA to LDCs accounted for only 0.09 per cent of DAC members’ GNI (figure 2.13), which is significantly lower than the SDG 17 targets. This gap between flows and commitments is a key contributor to underfunding of the SDGs in LDCs, particularly with regard to their structural transformation. If DAC member countries had met the 0.15–0.20 per cent target in 2021, ODA flows to LDCs would have amounted to an estimated \$35 billion–\$63 billion larger than what they actually disbursed. In 2021, only five DAC members – Denmark, Finland, Luxembourg, Norway and Sweden – reached the target of 0.15–0.2 per cent of GNI (figure 2.14).

**Figure 2.13**  
Sustainable Development Goal 17.2 targets vs. actual official development assistance disbursements by Development Assistance Committee members, 2002–2021



Source: UNCTAD secretariat calculations, based on data from (OECD, 2023b).

**Figure 2.14**  
Net official development assistance disbursements as a share of gross national income of Development Assistance Committee member countries to the least developed countries, 2021 (percentage)



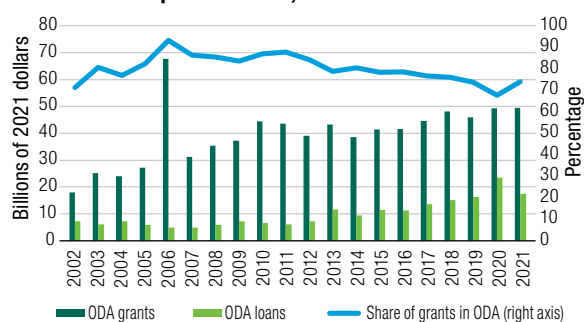
Source: UNCTAD secretariat calculations, based on data from United Nations, SDG Indicators database (accessed 23 May 2023).

#### 4. Composition of official development assistance flows to the least developed countries

An important issue relating to ODA is whether it takes the form of grants or loans. Both grants and loans can fill funding gaps in critical areas of the SDGs, and help advance implementation of the structural transformation agenda in LDCs. However, loans add to the debt burden of LDCs, and can thus fuel a problem in one area of sustainable development while aiming at solving a problem in another area. However, as a lack of adequate fiscal space is a key concern for LDCs (section B), debt-generating ODA in the form of loans constitutes a trade-off for these countries.

In the period 2012–2021, the share of grants in total ODA to LDCs was 76 per cent, a significant decline from the preceding decade (2002–2011), when they accounted for 85 per cent (figure 2.15). Disregarding the exceptional year 2006, when major debt relief caused a spike in the share of grants, would only slightly change the picture by reducing the share of grants to 83 per cent in 2002–2011. In 2020, the year the COVID-19 pandemic brought the global economy to a grinding halt, the share of grants reached its lowest point since 2002 (the start of the data series in the OECD *Creditor Reporting System*) at 67 per cent. Hence, while total ODA to LDCs increased in response

Figure 2.15  
Grants vs. loans in official development assistance flows to the least developed countries, 2002–2021



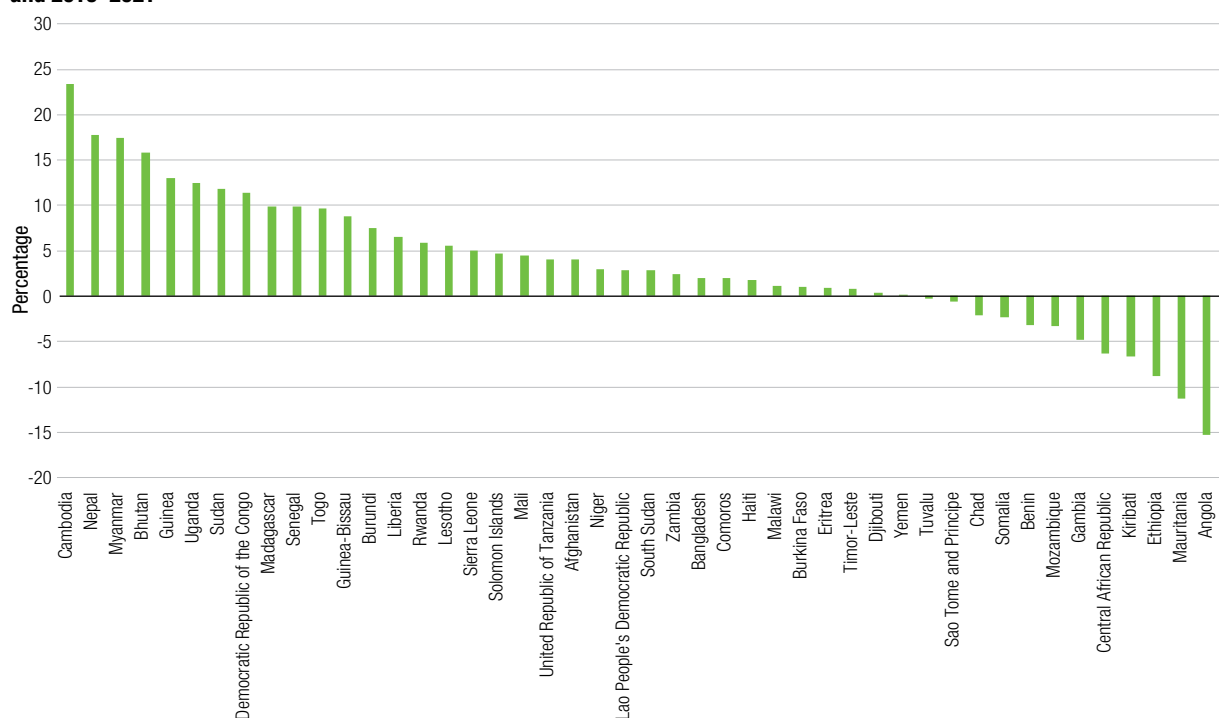
Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 24 May 2023).

Note: Equity investments are not presented, as they account for less than 1 per cent of total ODA flows to LDCs.

to the COVID-19 pandemic, the increase in flows was accompanied by a sudden and pronounced fall in the share of grants in ODA (down 6 percentage points from the previous year) and a corresponding rise in the share of loans.

The share of loans in total ODA flows increased for 28 out of 46 LDCs from the period 2016–2018 to 2019–2021, while it decreased for only 10 LDCs (figure 2.16). For eight LDCs, the share of loans was roughly stable in both periods, registering a change in the range of -1 to 1 percentage points. Cambodia

Figure 2.16  
Change in the share of loans in total official development assistance flows to least developed countries between 2016–2018 and 2019–2021



Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 5 May 2023).

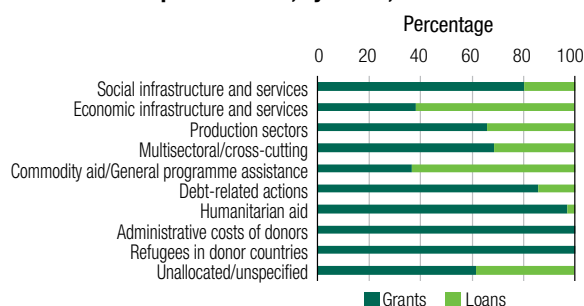
experienced the largest change, with an increase of 23 percentage points, which brought its share of loans to 57 per cent in the period 2019–2021.

The share of grants and loans in ODA differs substantially across sectors (figure 2.17). For instance, in the social infrastructure and services sector, which accounts for the largest share of ODA flows to LDCs, the share of grants was 80 per cent in the period 2019–2021. However, the shares of grants in production sectors and economic infrastructure and services – two key areas for structural transformation in LDCs – were much lower, at 66 and 38 per cent respectively. The relatively low shares of grants in these two latter areas are problematic as it means that LDCs need to trade off investments in crucial areas of structural transformation funded through ODA against an increase in debt burdens, which shrinks their fiscal space. At best, this constitutes an obstacle to their structural transformation; at worst, the lower share of grants in these sectors hampers critical, forward-looking investments that could shape the growth and development prospects of LDCs and their attainment of the SDGs by 2030.

Mobilizing private financing can be an important option for LDCs, given their limited domestic resources and insufficient ODA inflows. In this context, the growth of private finance, mobilized by official development finance interventions – so-called blended finance – has given rise to a debate about its potential benefits for LDCs.

While the bulk of blended finance continues to go to other developing countries, LDCs have been receiving an increasing share in the 2010s (figure 2.18). For instance, in the period 2019–2021, LDCs received a cumulative amount of \$21.7 billion in blended finance, corresponding to 16 per

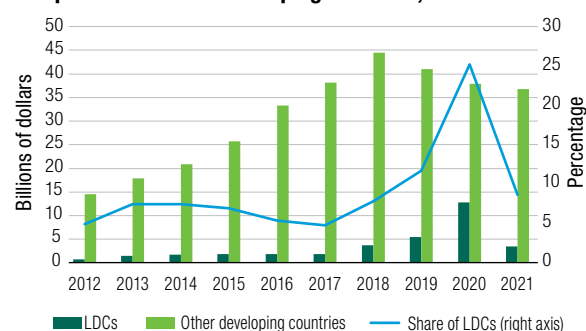
**Figure 2.17**  
**Grants vs. loans in official development assistance flows to the least developed countries, by sector, 2019–2021**



Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 25 May 2023).

Note: Equity investments are not presented and are not included in the calculation of grant and loan shares as they account for less than 1 per cent of total ODA and are absent in several sectors.

**Figure 2.18**  
**Flows of blended finance to the least developed countries compared with other developing countries, 2012–2021**



Source: UNCTAD secretariat calculations, based on data from OECDStat database (accessed 25 May 2023).

cent of total flows to developing countries.<sup>22</sup> This represents a substantial increase from the period 2016–2018, when cumulative flows amounted to \$7.6 billion, or 6 per cent of total flows to developing countries. However, it must be noted that flows of blended finance are highly unequal across LDCs. The five largest recipients in the period 2019–2021 – Bangladesh, Ethiopia, Guinea, Mozambique and Rwanda – received a share of 70 per cent of the LDC total (compared with 50 per cent in 2016–2018). In the period 2017–2021, multilateral institutions were the largest mobilizers of blended finance, accounting for 71 per cent of total flows to LDCs, while 29 per cent of the total was mobilized by DAC countries.<sup>23</sup>

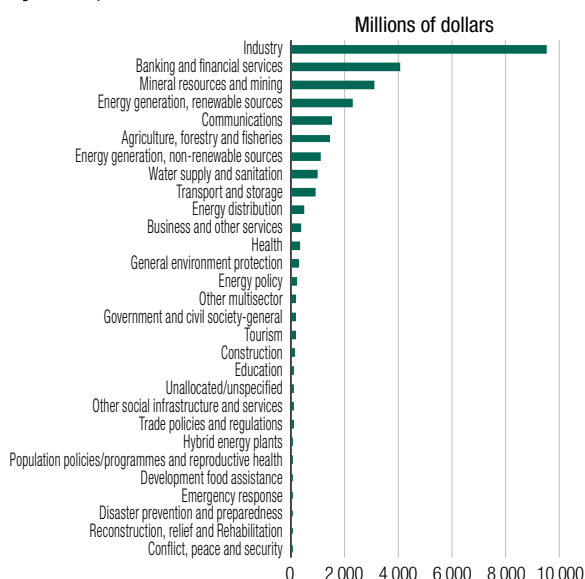
While flows of blended finance to LDCs tended to be concentrated in sectors that generate revenue, such as energy, and banking and financial services (OECD and UNCDF, 2020; UNCTAD, 2019), more recent data show an increase in such flows to the industrial sector. Indeed, it became the largest target sector for target finance in the period 2017–2021, receiving a total of \$9.5 billion (figure 2.19). On the other hand, barely any blended finance went to important sectors for LDCs, such as disaster prevention and preparedness or conflict, peace and security – a critical area for fragile and conflict-affected LDCs.

Overall, recent data show a rising trend in flows of blended finance to LDCs. However, the high level of country and sectoral concentration of blended finance among and within LDCs warrants caution in assessing its potential contribution to the achievement of the SDGs (UNCTAD, 2019). With this in mind, bilateral ODA providers and multilateral agencies that seek to mobilize increasing volumes of blended finance for LDCs should

<sup>22</sup> UNCTAD secretariat calculations, based on data from OECDStat database (accessed 25 May 2023).

<sup>23</sup> UNCTAD secretariat calculations, based on data from OECDStat database (accessed 25 May 2023).

**Figure 2.19**  
Flows of blended finance to the least developed countries, by sector, 2017–2021



Source: UNCTAD secretariat calculations, based on data from OECDStat database (accessed 5 May 2023).

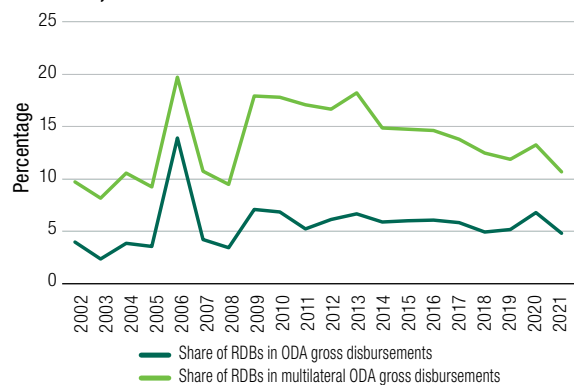
ensure that such flows align with LDC priorities, national development plans and national investment plans. Finally, LDCs need to ensure that private investments contribute to sustainable development without causing negative side effects. In this regard, it is important for them to devise rules and regulations that mitigate potential environmental and social risks, promote transparency and protect local communities.

## 5. The role of regional and subregional development banks

Regional development banks (RDBs) play a significant role in the development finance space of LDCs. In 2021, they accounted for 5 per cent of total gross ODA disbursements and 11 per cent of gross disbursements from multilateral institutions to LDCs (figure 2.20). However, there are large differences between and within regions. In Asia, RDBs play a much more important role for LDCs than in Africa. In the period 2017–2021, RDBs accounted for 10 per cent of total gross ODA disbursements to the median Asian LDC, whereas their share was only 4 per cent in the median African LDC (figure 2.21). In the same period, RDBs accounted for 11 and 25 per cent of total and multilateral ODA gross disbursements to Haiti, respectively.

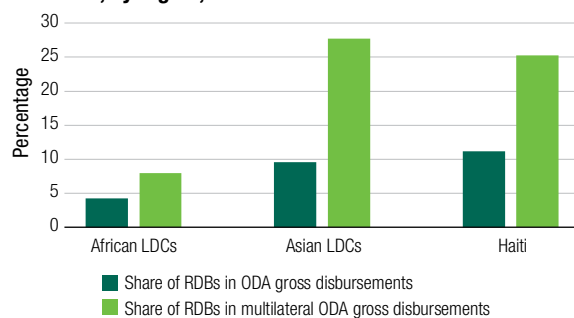
At country level, the largest shares of RDBs in total ODA flows to LDCs go to Bhutan followed by Nepal, Cambodia and the Lao People's Democratic Republic (table 2.1), thus underscoring the relatively larger role of RDBs in Asian LDCs. At the other end of

**Figure 2.20**  
Shares of regional development banks in total official development assistance flows and multilateral official development assistance flows to the least developed countries, 2002–2021



Source: UNCTAD secretariat calculations, based on data from the OECD Creditor Reporting System database (accessed 5 May 2023).

**Figure 2.21**  
Shares of regional development banks in total official development assistance flows and multilateral official development assistance flows to the least developed countries, by region, 2017–2021



Source: UNCTAD secretariat calculations, based on data from the OECD Creditor Reporting System database (accessed 14 May 2023).

Note: Data reflect median shares of countries in groups.

the spectrum are fragile and conflict-affected LDCs, including the Central African Republic, Somalia, South Sudan and Yemen. Overall, there are only two African LDCs (the Comoros and Sao Tome and Principe) where RDBs accounted for more than 10 per cent of ODA gross disbursements in the period 2017–2021. This suggests that there could be scope for an expansion of RDB activity in African LDCs.

RDBs already play a significant role in bond markets in Africa (see chapter 3). For example, the African Development Bank (AfDB) has established bond programmes and issued bonds, including in the currencies of the African LDCs.<sup>24</sup> Subregional financial entities can also help countries raise capital. For

<sup>24</sup> See, for example, <https://www.afdb.org/fr/news-and-events/afdb-returns-to-the-ugandan-capital-market-with-its-second-shilling-bond-11822> (accessed 28 June 2023).



Table 2.1

**Shares of regional development banks in official development assistance flows and multilateral official development assistance flows to the least developed countries, by country, 2017–2021 (percentage)**

Country	Share of RDBs in ODA gross disbursements	Share of RDBs in multilateral ODA gross disbursements
Bhutan	36.7	47.0
Nepal	19.6	30.5
Cambodia	17.5	46.9
Lao People's Democratic Republic	15.8	37.7
Tuvalu	15.4	29.9
Sao Tome and Principe	12.3	17.2
Comoros	12.2	23.8
Haiti	11.2	25.2
Bangladesh	10.4	21.7
Gambia	9.9	13.6
Kiribati	8.8	30.7
Djibouti	7.6	14.6
Guinea-Bissau	6.8	8.9
Guinea	6.6	10.0
Democratic Republic of the Congo	6.2	12.0
Rwanda	6.1	10.9
Solomon Islands	6.1	25.6
Liberia	6.0	12.9
Togo	5.9	8.1
Timor-Leste	5.9	24.8
United Republic of Tanzania	5.8	11.9
Chad	5.6	8.8
Niger	4.9	8.1
Afghanistan	4.9	16.5
Madagascar	4.7	7.1
Benin	4.5	7.9
Sierra Leone	4.5	7.5
Sudan	4.3	9.5
Myanmar	4.2	13.4
Uganda	4.1	8.8
Ethiopia	4.0	7.8
Mali	3.9	8.5
Lesotho	3.9	6.9
Burkina Faso	3.9	6.7
Malawi	3.6	7.3
Burundi	3.4	5.7
Angola	3.3	5.9
Mozambique	2.9	6.9
Eritrea	2.9	7.5
Mauritania	2.8	4.3
Senegal	2.6	5.6
Zambia	2.6	6.6
Central African Republic	2.5	4.6
Somalia	2.0	7.1
South Sudan	1.1	5.0
Yemen	0.1	0.6

Source: UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System*.

Note: Figures reflect median shares of countries in groups.

instance, UEMOA-Titres help member-States of the West African Economic and Monetary Union (WAEMU) – among them Benin, Burkina Faso, Guinea-Bissau, Mali, the Niger, Senegal and Togo – to issue government securities (Soumaré et al., 2021; AfDB, 2016). Within the East African Community (EAC), the East African Development Bank is committed to developing capital markets in the region, and has successfully facilitated cross listings within the EAC member States.

In addition to RDBs, regional standard-setting bodies can play a role in supporting the development of sustainable financial systems and initiatives on sustainable financing in LDCs (box 2.2).

Overall, the RDBs play an important role in financing the development efforts of LDCs, but not all LDCs benefit from RDB financing to the same degree. This suggests that there is scope for RDBs to have a stronger impact in LDCs, particularly African LDC where RDBs have a relatively small footprint in the development finance landscape. In this regard, increasing the capitalization of RDBs would make them better prepared to respond to future crises that require the fast deployment of financial resources in LDCs. In this context, channelling Special Drawing Rights (SDRs) through RDBs could play a catalytic role (UNCTAD, 2023c).

## Box 2.2 Regional standard-setting bodies for sustainable finance

Standard-setting bodies for sustainable finance play a crucial role in promoting this form of finance by developing and implementing relevant standards and guidelines. Their standards and guidelines help to promote greater harmonization of regulations across countries and regions, and ensure that sustainable finance is conducted in a transparent and consistent manner. This can boost investor confidence in the market and build trust among stakeholders. Additionally, standard-setting can help to promote innovation and competition in financial markets by providing a level playing field for market participants.

In Asia, the Capital Markets Forum of the Association of Southeast Asian Nations (ASEAN) is at the forefront of promoting sustainable finance in the region through its different initiatives, including developing standards for various types of bonds issued in the region. It developed the ASEAN Green Bond Standards in 2017, as well as the ASEAN Social Bond Standards and the ASEAN Sustainability Bond Standards in 2018 (ACMF, 2019). The standards complement each other, and are aimed at enhancing consistency and transparency in the region's bond issuances, supporting the development of new instruments, reducing due diligence costs and facilitating decision-making by investors.

Within Africa, however, countries adhere to standards issued by international organizations, such as the International Organization of Securities Commission and the International Capital Markets Association. It is important to note that some of the standards issued are voluntary, and therefore do not require strict adherence. Individually, some countries in the region have sought to develop appropriate policies to regulate and promulgate guidelines and standards for capital markets in general. However, there are fewer attempts to establish standards at the regional and subregional levels. This is partly due to the small and underdeveloped nature of regional bond markets in Africa, but also because bond markets are dominated by sovereign issuances.

As regional integration takes root in Africa, it would be important to establish regional standard-setting bodies for sustainable finance. Before this can happen, there should be a clear understanding of the need for such bodies and the benefits that they could bring to the region.

Establishing standard-setting bodies for sustainable finance in Africa at the regional or subregional level would require the collaboration of different stakeholders, particularly governments and financial institutions, as well as their commitment to establishing such bodies. Such collaboration and commitment would pave the way for ownership of and engagement with the regional bodies once they are created. The process would also involve identifying the key issues and challenges facing the region, with regard to bond markets, and developing a framework for addressing them. Such a framework would include formulating the appropriate standards, guidelines, policies and regulations that promote sustainable finance, and encouraging investment in sustainable projects. Finally, an appropriate institutional and governance structure would need to be put in place to oversee the development and implementation of the standards. It is important to have LDC representation within the institutional structure of standard-setting bodies, to ensure that these countries' concerns are voiced and given due consideration.

Source: UNCTAD secretariat.

## D. Climate finance in the least developed countries

### 1. The least developed countries and climate change

While the LDCs contribute only marginally to global GHG emissions, they stand at the forefront of climate change impacts (UNCTAD, 2022a). Both historical and contemporaneous GHG emissions of LDCs are dwarfed by those of other country groups. In 2021, the 46 LDCs jointly accounted for 1.7 gigatons of carbon dioxide (CO<sub>2</sub>)-equivalent GHG emissions, which constitutes a mere 3.4 per cent of global GHG emissions (figure 2.22). In contrast, other developing countries and developed countries emitted 30.8 gigatons (63.3 per cent of global emissions) and 16.2 gigatons of CO<sub>2</sub>-equivalent GHGs (33.3 per cent of global emissions), respectively, in the same

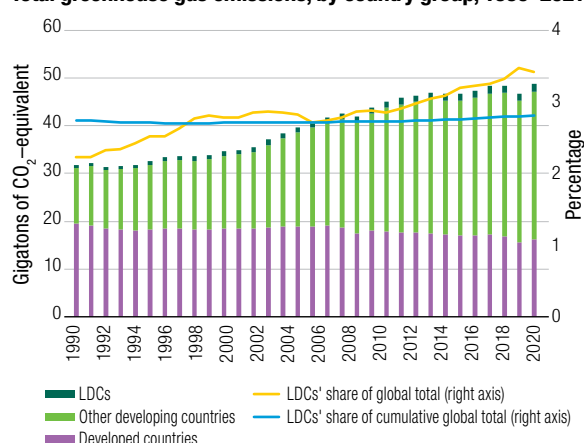
year. The share of LDCs in cumulative global GHG emissions in the period 1850–2021 was even smaller, at 2.8 per cent, in 2021. Thus, the LDCs' contribution to the current climate crisis has been insignificant, and yet that crisis poses a major threat to their development prospects.

Per capita emissions show a similar pattern (figure 2.23). In LDCs, per capita emissions have essentially remained flat since 1990 and were 1.5 tons of CO<sub>2</sub>-equivalent in 2021. By contrast, the average person in other developing countries and developed countries was responsible for more than three times (5.6 tons of CO<sub>2</sub>-equivalent) and more than eight times more GHG emissions (12.2 tons of CO<sub>2</sub>-equivalent), respectively, in 2021.

However, the picture changes drastically when vulnerability to the impacts of climate change is considered. According to the University of Notre Dame's *Global Adaptation Initiative* (ND-GAIN)

Figure 2.22

Total greenhouse gas emissions, by country group, 1990–2021

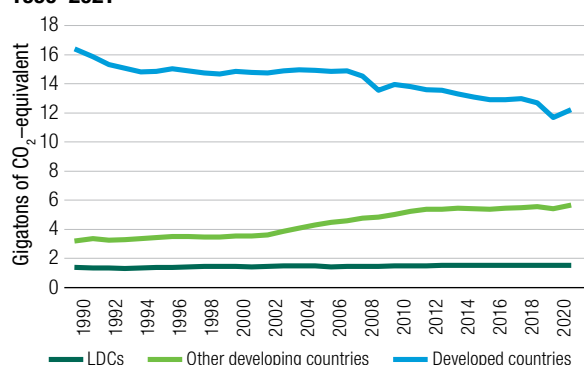


Source: UNCTAD secretariat calculations, based on data from the Potsdam Institute for Climate Impact Research *PRIMAP-hist* dataset, obtained through the Climate Watch data portal (accessed 14 May 2023).

Note: Data include total CO<sub>2</sub>-equivalent emissions of the gases covered by the Kyoto Protocol (i.e. carbon dioxide (CO<sub>2</sub>), methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O) and the so-called F-gases) from all sources, excluding land use, land-use change and forestry.

Figure 2.23

Greenhouse gas emissions per capita, by country group, 1990–2021



Source: UNCTAD secretariat calculations, based on data from the Potsdam Institute for Climate Impact Research *PRIMAP-hist* dataset, obtained through the Climate Watch data portal; and DESA (2022) for population data (both accessed 14 May 2023).

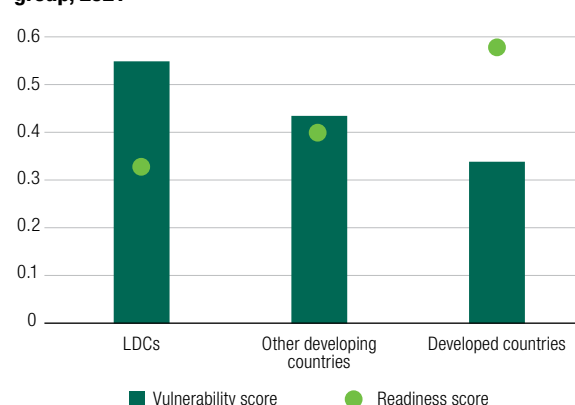
Notes: Data refer to population-weighted group averages. They include total CO<sub>2</sub>-equivalent emissions of the gases covered by the Kyoto Protocol (see note to figure 2.23); per capita figures were calculated using population figures from the World Bank, *World Development Indicators* database, as individual datapoints are missing in the per capita figures provided through the Climate Watch data portal.

Index,<sup>25</sup> the LDC group of countries is the most vulnerable to the impacts of climate change (figure 2.24), but it also has the lowest readiness score. This score measures a country's ability to leverage investments to adaptation actions. In 2021, there were 17 LDCs among the 20 countries with the lowest ND-GAIN score, which combines measures of vulnerability and readiness (table 2.2).

<sup>25</sup> See <https://gain.nd.edu/our-work/country-index> for the ND-GAIN Index and its components.

Figure 2.24

Vulnerability to the impacts of climate change, by country group, 2021



Source: UNCTAD secretariat calculations, based on data from the University of Notre Dame's *Global Adaptation Initiative* (ND-GAIN) dataset (accessed 12 October 2023).

Note: Data for Kiribati, South Sudan and Tuvalu were not available.

Table 2.2

Countries with the lowest Notre Dame Global Adaptation Initiative score in 2021

Country (LDCs are listed in bold)	ND-GAIN score
<b>Chad</b>	27.0
<b>Central African Republic</b>	27.7
<b>Eritrea</b>	30.8
<b>Democratic Republic of the Congo</b>	32.4
<b>Guinea-Bissau</b>	32.5
<b>Afghanistan</b>	32.8
<b>Sudan</b>	32.8
<b>Somalia</b>	33.8
<b>Liberia</b>	34.1
<b>Mali</b>	34.6
Congo	35.0
<b>Yemen</b>	35.0
<b>Uganda</b>	35.1
<b>Madagascar</b>	35.3
<b>Niger</b>	35.5
<b>Burundi</b>	35.5
<b>Haiti</b>	35.5
Zimbabwe	35.6
Papua New Guinea	36.8
<b>Sierra Leone</b>	37.0

Source: UNCTAD secretariat calculations, based on data from the University of Notre Dame's *Global Adaptation Initiative* (ND-GAIN) dataset.

Note: Data for Kiribati, South Sudan and Tuvalu were not available.

## 2. Climate finance flows to the least developed countries

Since the adoption of the UNFCCC in 1992, climate finance has been one of the key issues discussed, and is also a major source of friction between developing and developed countries. Developed countries agreed to financially support developing countries in

meeting the costs of climate change mitigation and adaptation. And Article 4, paragraph 9 of the UNFCCC recognizes the specific needs of the LDCs.<sup>26</sup> These commitments were reiterated and further specified in subsequent Conferences of the Parties (COPs) to the UNFCCC in parallel with the development of a global climate finance architecture (box 2.3).

A landmark in the history of climate finance negotiations within the UNFCCC was the Copenhagen Accord reached at COP15 in 2009,<sup>27</sup> which included a climate finance target of \$100 billion annually for

developing countries, to be mobilized by Annex-II countries by 2020.<sup>28</sup> The \$100 billion target was later also included in the SDG framework (Target 13.a), and became the first benchmark against which global climate finance flows are measured. However, this figure represents a political consensus rather than the actual needs of developing countries. Latest estimates show that developing countries' finance needs for adaptation alone are in the range of \$160 billion–\$340 billion per year by 2030 and \$315 billion–\$565 billion per year by 2050 (UNEP, 2022). The Glasgow Climate Pact signed

### Box 2.3 The global climate finance architecture: A complex and fragmented landscape

Article 21.3 of the UNFCCC laid the foundation of the global climate finance architecture, designating the Global Environment Facility (GEF), co-administered by the World Bank, the United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP), as the operating entity of its financial mechanism on an interim basis. Since then, numerous climate funds have been established, including bilateral funds, multilateral funds – both under the aegis of and external to the UNFCCC – regional and national funds.

Multilateral funds under the UNFCCC include the Least Developed Countries Fund (LDCF) and the Special Climate Change Fund (SCCF), both established in 2001 and made operational in 2002, and the Adaptation Fund (AF), also established in 2001 but only becoming operational in 2009. These three funds are administered by the GEF, with the World Bank as interim trustee. Funds independent of the UNFCCC include the Forest Carbon Partnership Facility (FCPF), a multi-donor trust fund administered by the World Bank that provides finance for reducing emissions from deforestation and forest degradation, among others; and the Climate Investment Funds (CIFs), also administered by the World Bank, which comprise the Clean Technology Fund (CTF), which focuses on low-carbon technologies, and the Strategic Climate Fund (SCF). The latter provides funding for the Forest Investment Program (FIP), the Pilot Program for Climate Resilience (PPCR) and the Scaling Up Renewable Energy in Low Income Countries program (SREP).

Bilateral climate funds include the International Climate Initiative (IKI) established by the Government of Germany in 2008, which approved €5 billion for more than 950 projects engaged in mitigation, adaptation and biodiversity protection in its first 15 years of operation (IKI, 2023); Norway's International Climate and Forest Initiative (NICFI), also established in 2008, which has a focus on REDD+ projects;<sup>a</sup> and the United Kingdom's International Climate Finance (ICF), which approved £5.8 billion in climate funding in the period 2016–2021 and increased the commitment to spend £11.6 billion between April 2021 and March 2026 (United Kingdom, Foreign, Commonwealth and Development Office, 2021).

The decision to establish the Green Climate Fund (GCF) as the second operating entity of the Financial Mechanism under the UNFCCC was taken at COP16 in Cancún, Mexico. After the GCF was officially launched in 2011 during COP17 in Durban, South Africa, it became operational in 2014. The GCF is now the largest dedicated climate fund with combined pledges and contributions amounting to \$19.2 billion by 30 April 2023 (\$9.3 billion during the initial resource mobilization phase and \$9.9 billion during the first replenishment round) (GCF, 2023).

The result of this proliferation of funding sources and channels for international climate finance is a complex and fragmented landscape (box figure 2.2) with decentralized governance that can be difficult to navigate, especially for LDCs with limited institutional capacities. Selection criteria, application processes and reporting requirements differ from fund to fund, which increases transaction costs and creates heavy administrative burdens for LDCs. Moreover, there are often delays of several years between initial submission of project proposals and disbursement of funds. Finally, it should be noted that, in spite of the profusion of dedicated climate funds, the bulk of climate finance flows continues to be delivered through non-climate-specific ODA channels. This gives rise to a lack of transparency, and difficulty in establishing a unified and clear accounting framework for climate finance flows.

<sup>a</sup> REDD+ stands for Reducing Emissions from Deforestation and Forest Degradation, plus sustainable management of forests and the conservation and enhancement of forest carbon stocks.

<sup>26</sup> For instance, Article 4, paragraph 9 of the UNFCCC states that “The Parties shall take full account of the specific needs and special situations of the least developed countries in their actions with regard to funding and transfer of technology.”

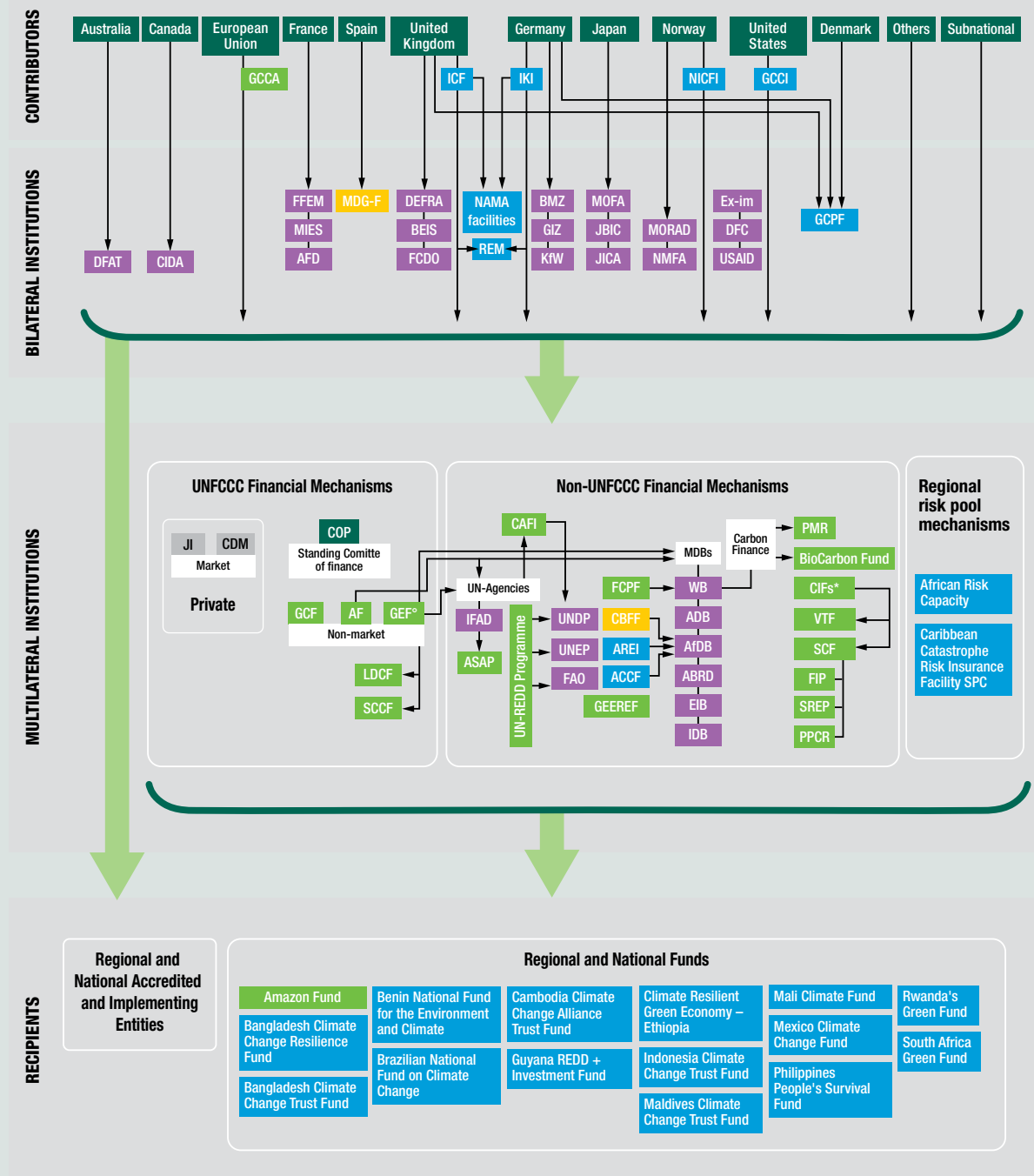
<sup>27</sup> UNFCCC (2009). Copenhagen Accord. Decision 2/CP.15.

<sup>28</sup> The so-called Annex-II countries are those required under the UNFCCC to provide climate finance to developing countries. The Annex-II countries comprise 23 OECD member States and the European Union.

Box 2.3 The global climate finance architecture: A complex and fragmented landscape (cont.)

Box figure 2.2

The global climate finance architecture



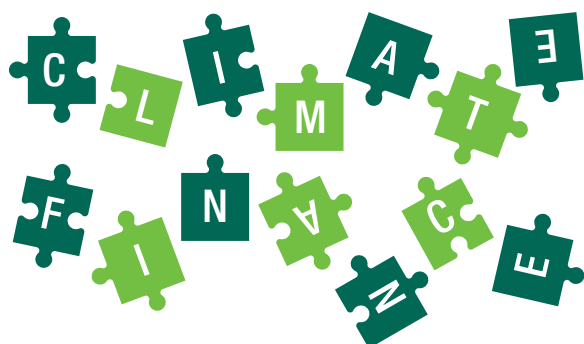
Note: The schematic is indicative of public climate finance flows and does not capture all climate finance funds and initiatives

- Dedicated climate finance funds and initiatives on CFU
- Implementing agencies
- Dedicated climate finance funds and initiatives not monitoring on CFU
- Closed dedicated climate funds previously tracked by CFU

\* The CIFs are administered by the World Bank  
 ° GEF serves as secretariat for all the non-market UNFCCC funds except the GCF

Source: Watson et al., 2023.

## Climate finance is inadequate in terms of quantity and quality, and its complex structure hinders access

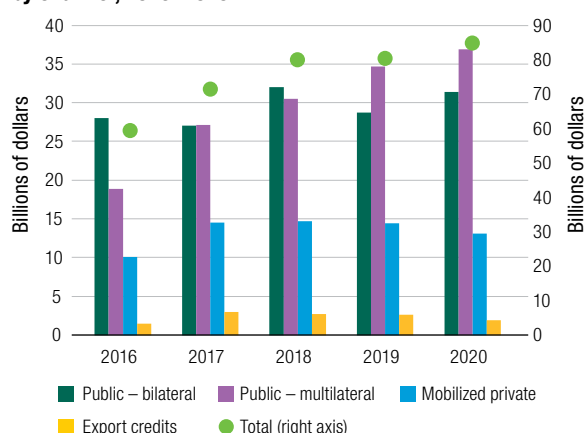


at COP26 in 2021 agreed to set a collective new climate finance target, with \$100 billion as the floor,<sup>29</sup> but to date no new global target has been agreed upon.

In spite of the enormous gap between the \$100 billion target and real needs, even this target has not been reached. Latest figures show a rising trend in climate finance flows to developing countries, but the OECD estimates that in 2020 – the target year specified in the Copenhagen Accord – total flows were \$83.3 billion, leaving a gap of \$16.7 billion (figure 2.25).

Despite repeated calls to balance adaptation and mitigation finance as envisaged by Article 9 of the Paris

**Figure 2.25**  
Climate finance flows to developing countries, by channel, 2016–2020



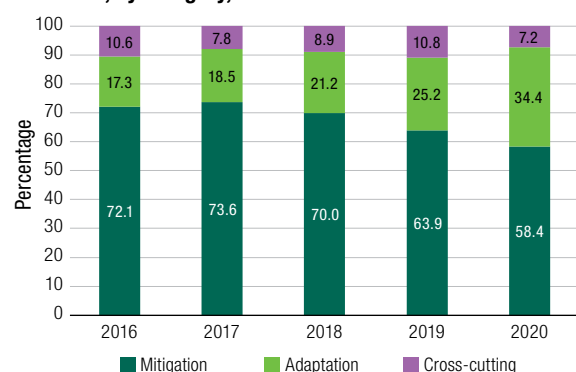
Source: UNCTAD secretariat calculations, based on data from OECD, 2022a.

<sup>29</sup> UNFCCC (2021). Glasgow Climate Pact. Decision 1/CMA.3.

Agreement,<sup>30</sup> and which constitutes a long-standing concern for developing countries – mitigation accounted for the majority (58.4 per cent) of total climate flows in 2020 (figure 2.26). Furthermore, the bulk of public climate finance continues to be delivered through loans (figure 2.27). In 2020, 71.4 per cent of total climate finance flows were in the form of loans, while only 26.3 per cent were in the form of grants, and equity accounted for a minor share of 2.3 per cent.

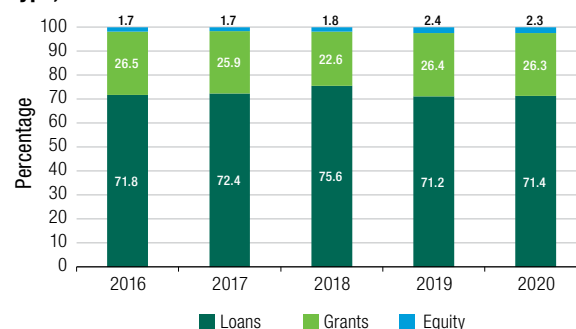
LDCs received an annual average of \$12.6 billion, or 17 per cent, of total climate finance provided and mobilized in the period 2016–2020 (OECD, 2022b). This share corresponded approximately to their share of the population of developing countries, which was 16.5 per cent in 2020.<sup>31</sup> It suggests that vulnerability and the capacity to cope with the negative impacts of climate change were not

**Figure 2.26**  
Climate finance to developing countries, provided and mobilized, by category, 2016–2020



Source: UNCTAD secretariat calculations, based on data from OECD, 2022a.  
Note: The category “unspecified” is not included in the graph as its share is close to zero.

**Figure 2.27**  
Public climate finance flows to developing countries, by type, 2016–2020



Source: UNCTAD secretariat calculations, based on data from OECD, 2022a.

<sup>30</sup> UNFCCC (2015). Paris Agreement. Decision 1/CP.21.

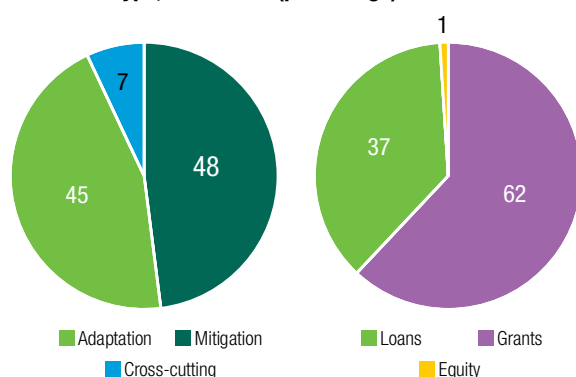
<sup>31</sup> According to data from DESA, 2022.

significant factors for climate finance flows to LDCs. Looking to the future, it is crucial that the LDCs receive climate finance flows that are commensurate with their high vulnerability to the impacts of climate change, low resilience to economic shocks, limited ability to mobilize domestic finance and enormous financing needs.

The LDCs received a larger share of climate finance flows for mitigation than for adaptation during the period 2016–2020: 48 per cent of flows for mitigation compared with 45 per cent for adaptation and 7 per cent for cross-cutting measures (figure 2.28, left panel). Furthermore, the funds for adaptation were not evenly spread across countries – more than 40 per cent went to the five largest LDCs (OECD, 2022b). Also, adaptation finance flows to LDCs were concentrated in terms of source, with public sources accounting for 93 per cent. The share of grants in climate finance flows to LDCs was higher than the average for all recipients, at 62 per cent during the period (figure 2.28, right panel).

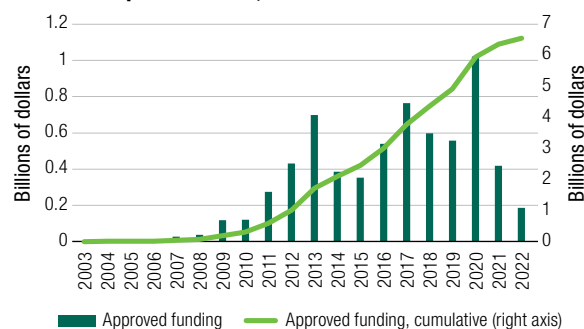
Cumulative approved climate flows to the LDCs that were channelled through climate funds amounted to \$6.5 billion in the period 2003–2021 (figure 2.29). This suggests that, despite their proliferation, dedicated climate funds only provide a small share of climate finance to the LDCs. The bulk of climate finance continues to be provided by bilateral donors and multilateral development banks through non-climate-specific channels, which does not contribute to transparency. In this context, a recent analysis of official data by the Overseas Development Institute (ODI) shows increases in some sectoral climate finance flows, even as the total volumes of official flows to these sectors remain unchanged, which points to “rebadging” of funds (Miller et al., 2023).

**Figure 2.28**  
Climate finance flows to the least developed countries, by sector and type, 2016–2020 (percentage)



Source: UNCTAD secretariat calculations, based on data from OECD, 2022b.

**Figure 2.29**  
Climate finance channelled through climate funds to the least developed countries, 2003–2021



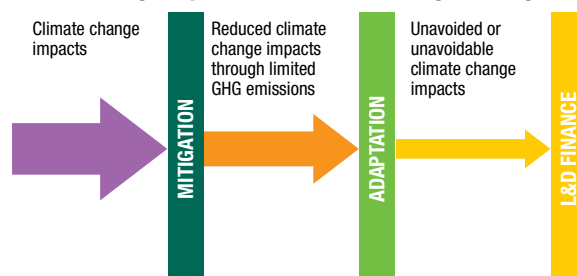
Source: UNCTAD secretariat calculations, based on data from climatefundsupdate.org (accessed 1 June 2023).

Note: The data exclude \$9.6 million worth of funding for two projects of the Congo Basin Forest Fund (CBFF), as the year of approval was not specified; included are regional adaptation projects in the Pacific Islands jointly worth \$33.96 million, which are funded by the Least Developed Country Fund and include Vanuatu as a beneficiary.

### 3. The Loss and Damage Fund: A game changer for least developed countries?

Even if the objectives of the Paris Agreement are met, climate change will continue to cause loss and damage (L&D) around the world. Developing countries have long called for a financing mechanism that would compensate them for climate-related L&D. Indeed, L&D financing can be characterized as the last line of defence to safeguard progress towards the SDGs against the impacts of climate change in the most vulnerable countries (figure 2.30). As previously noted, since LDCs are among the most vulnerable countries to the impacts of climate change (section D.1), they are directly affected by the outcomes of negotiations on L&D funding.

**Figure 2.30**  
Climate change impacts, and loss and damage funding



Source: UNCTAD secretariat.

The first mention of means to address loss and damage in COP decisions can be found in the Bali Action Plan, emanating from COP13 in 2007.<sup>32</sup> Other

<sup>32</sup> UNFCCC (2007). Bali Action Plan. Decision 1/CP.13.

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## **L&D financing to LDCs is critical to safeguard their progress towards the Sustainable Development Goals while dealing with the impacts of climate change**

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milestones include the launch of an L&D workstream at COP16 in Cancún, Mexico, in 2010, and the establishment of the Warsaw International Mechanism (WIM) and its executive committee at COP19 in 2013. The WIM subsequently became the main entity within the UNFCCC to address climate-related L&D in developing countries. The Paris Agreement of 2015 includes an important step forward to “enhance understanding, action and support...with respect to L&D associated with the adverse effects of climate change” by mandating the WIM to create a clearing house for climate risk transfer and establishing a task force on climate-change-related displacement. The Fiji Clearing House for Risk Transfer, a repository for information on insurance and risk transfer aiming at facilitating the development and implementation of risk management strategies, was launched two years later at COP23 in 2017. Another milestone was reached at COP25 in Madrid in 2019, when the Santiago Network on Loss and Damage was created for “averting, minimizing and addressing loss and damage associated with the adverse effects of climate change”. This network aims to connect developing countries with providers of technical assistance, knowledge and resources, which they need for addressing climate risks. At COP26 in Glasgow, United Kingdom in 2021, developing countries called for the establishment of an L&D finance facility, but the Glasgow Climate Pact fell short of developing countries’ expectations by only including a call to developed countries “to provide enhanced and additional support for activities addressing loss and damage” from climate change.<sup>33</sup>

Finally, at COP27 in Sharm el-Sheikh, Egypt in 2022, a breakthrough was achieved when countries decided to establish a dedicated Loss and Damage Fund (LDF) (UNFCCC, 2022), and agreed on arrangements for its operationalization. In particular, a transitional committee was established and tasked with developing, inter alia, institutional arrangements, governance and terms of reference of the new fund, as well as ensuring coordination and complementarity with existing

funding arrangements.<sup>34</sup> The transitional committee’s deadline for the delivery of recommendations on the operationalization of the LDF is COP28, scheduled to take place in Dubai, United Arab Emirates from 30 November to 12 December 2023.

As a cross-cutting global phenomenon impacting all areas of human, animal and plant life, climate change is causing L&D across several areas. This includes both impacts of slow-onset phenomena related to climate change (e.g. higher average temperatures, rising sea levels and desertification), and extreme weather events (e.g. droughts, floods and tropical cyclones), which are likely to become more frequent and more severe with global warming (IPCC, 2022). Loss and damage caused by climate-related phenomena can be economic (e.g. damages to infrastructure or loss of income) or non-economic (e.g. loss of life, negative health effects, deterioration of ecosystems or loss of cultural heritage). While it is methodologically challenging to measure L&D, in particular non-economic damage, existing estimates suggest significant costs. For example, the Vulnerable Twenty Group (V20) estimated losses attributable to climate change in member countries for the period 2000–2019 at 0.92 per cent of GDP growth per year or 20 per cent of GDP in 2019 (V20, 2022).<sup>35</sup> Another estimate puts L&D financing needs in developing countries at \$290 billion–\$580 billion in 2030, \$551 billion–\$1,016 billion in 2040 and \$1,132 billion–\$1,741 billion in 2050 (Markandya and González-Eguino, 2019). Recent disasters illustrate the scale of funding needed for effective actions to address L&D. For instance, estimates of the costs of the damage from floods in Pakistan in 2022 amount to \$14.9 billion, and economic loss is estimated to be \$15.2 billion ((Pakistan, Ministry of Planning Development & Special Initiatives, 2022).

<sup>34</sup> The 24-member transitional committee comprises 10 members from developed countries and 14 members from developing countries, 3 each from Africa, Asia and the Pacific, and Latin America and the Caribbean, 2 each from SIDS and LDCs, and 1 from a developing country not included in the listed categories. Currently (as of 10 May 2023), the transitional committee has 3 LDC members representing Bhutan, the Sudan and Timor-Leste (included under the regional quota for Africa).

<sup>35</sup> The Vulnerable Twenty Group (V20) Group of Ministers of Finance has its roots in the Climate Vulnerable Forum (CVF), a global partnership of countries that are particularly vulnerable to the impacts of climate change, which was created ahead of COP15 in 2009. In 2015, 20 countries of the CVF formed the V20, which has since grown to 55 members, among them 26 LDCs. The main objectives of the V20 are to raise funds for climate finance, share best practices on economic aspects of climate action and engage in joint advocacy (see <https://www.v-20.org/about>, accessed 24 May 2023).

<sup>33</sup> UNFCCC (2021). Glasgow Climate Pact. Decision 1/CMA.3.



Key issues for the operationalization of the LDF include mobilization of finance, and how to ensure complementarity and additionality with existing climate finance mechanisms. Proposals made include new taxes and levies, such as an aviation levy, a global wealth tax, an international shipping levy, and a windfall profit tax to be imposed on the fossil fuel industry (Richards et al., 2023). At COP27, United Nations Secretary-General, called for a windfall profit tax on fossil fuel companies, and for some of their proceeds to be directed towards support for L&D.<sup>36</sup> Chapter 5 spells out the criteria that need to be met in order to enhance the impact of the LDF in LDCs.

## E. Summary and policy considerations

As a consequence of multiple global crises, LDCs are facing an erosion of their fiscal space, which increases their vulnerability to future shocks and volatility. This threatens their growth and development prospects. Thus they are in urgent need of the kind of support that would enable them to expand their fiscal space so that they can invest in green structural transformation, develop resilience and bolster their efforts towards achieving the SDGs.

ODA remains the bedrock of external financing for sustainable development in LDCs. However, ODA flows to LDCs remain substantially lower than the commitments made by developed countries, as well as the targets set in SDG 17 and the DPoA. It is necessary to increase ODA disbursements to the committed levels in order to boost growth and resilience in the LDCs. Supporting these countries in their efforts to achieve the SDGs should be considered a high priority. At the very least, the emergence of new and additional funding instruments should not lead to a reduction of ODA flows to LDCs. However, preliminary figures for 2022 suggest that ODA flows from DAC countries to LDCs are declining.<sup>37</sup> A reversal of this trend is critical for the LDCs to pursue their development agendas.

Scaling up grants should be a priority in order to counteract LDCs' shrinking fiscal space. While loans can also play an important role in financing for sustainable development, they add to the mounting

## The shrinking fiscal space of LDCs increases their vulnerability to future shocks and volatility

debt burdens of LDCs, and therefore further reduce their fiscal space and increase the risk of debt distress. Increasing financing for sustainable development and better aligning it with recipients' priorities is crucial to ensure that the LDCs do not fall further behind in their efforts to achieve the SDGs. The bulk of ODA grants goes to social services, such as education and health, which are, no doubt, of major importance for the SDGs, but more funding is also needed to support other sectors that are critical for structural transformation, such as infrastructure and industrial development. Also, ODA grants targeting the agriculture sector, which plays a key role in food security (box 2.1 and UNCTAD, 2015b), as well as in employment and rural development in LDCs, need to be increased. Instead, they declined by 12 per cent in the period 2016–2021, and accounted for only a minor share of 5 per cent of total ODA grants to LDCs in 2021.<sup>38</sup>

Climate finance for LDCs needs to improve in each of its main dimensions: quantity, quality and the global climate finance architecture. The amount of climate finance flows to LDCs has fallen short of international commitments, let alone for meeting their actual needs. Countries failed to reach the target of \$100 billion by 2020, as stipulated in the Copenhagen Accord of 2009, and, although it could be reached in 2023, it represents only a fraction of developing countries' needs. Moreover, as 14 years have passed since the target was set, the real value of \$100 billion has significantly eroded: taking the United States Consumer Price Index as a measure of inflation, \$100 billion at December 2009 prices (the month the Copenhagen Accord was signed) would correspond to \$141 billion in May 2023 dollars.<sup>39</sup> Furthermore, improving transparency and standardizing accounting rules for climate finance flows is crucial to ensure additionality (rather than the diversion) of funds and accountability vis-à-vis commitments.

While the specific needs of LDCs have been recognized since the very inception of the UNFCCC in 1992, and

<sup>36</sup> See <https://news.un.org/en/story/2022/11/1130247> (accessed 24 May 2023).

<sup>37</sup> OECD, 2023, ODA Levels in 2022 – preliminary data. Detailed summary note. Available at <https://www.oecd.org/dac/financing-sustainable-development/ODA-2022-summary.pdf>.

<sup>38</sup> UNCTAD secretariat calculations, based on data from the OECD *Creditor Reporting System* database (accessed 28 June 2023).

<sup>39</sup> Based on the United States Bureau of Labor Statistics CPI Inflation Calculator, available at [https://www.bls.gov/data/inflation\\_calculator.htm](https://www.bls.gov/data/inflation_calculator.htm) (accessed 22 June 2023).

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## Increasing the funding for adaptation and the share of grants could enhance the impact of climate finance in LDCs

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reiterated in subsequent policy documents, such as the Paris Agreement, no LDC-specific funding targets have been stipulated within the framework of the UNFCCC, the SDG framework or the DPoA,<sup>40</sup> and recognition of the special needs and climate-related vulnerabilities of LDCs has not translated into larger-than-average climate finance flows to these countries. Given the vulnerabilities of many LDCs to the impacts of climate change, setting a climate finance target specific to these countries could help reduce the immense funding gap that they face for climate-related investments, in particular for adaptation. In this context, it should be stressed that adaptation investments are not only defensive expenditures; they can also generate economic, environmental and social benefits (Global Commission on Adaptation, 2019).

In addition to significantly scaling up climate finance flows to LDCs, the impact of existing funding could be enhanced by better targeting, in particular by increasing the share of adaptation and the share of grants in total flows. The latter is key to avoiding a climate debt trap.

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<sup>40</sup> The Least Developed Countries Fund (LDCF) under the UNFCCC aims at funding adaptation in LDCs, but it is based on voluntary contributions, and available funds are inadequate to address climate change adaptation in LDCs in a systematic manner. As on 31 March, 2022 (about 20 years after the fund became operational in 2002), cumulative pledges to the LDCF amounted to only \$2 billion (GEF, 2022).

The LDF, which is currently in the making, could play an important role if sufficient additional funds were to be made available to LDCs in the form of grants, and if the LDF, once established, is able to make disbursements rapidly. Furthermore, it is critical that transaction costs and institutional requirements for LDC governments to access the funds are kept to a minimum, and that allocation takes multidimensional vulnerabilities into account. If these criteria are met, the LDF has the potential to significantly boost the resilience of LDCs as they strive to achieve the SDGs while also dealing with the impacts of climate change.

Finally, in order to address the systemic and interconnected challenges related to fiscal space, debt (see chapter 3) and climate change in LDCs, bold and lasting solutions are needed. Proposals for deep reform include those made by the United Nations in the context of the Secretary-General's *Our Common Agenda* report, which outlines a broad-based programme, including an overhaul of the international financial architecture and the mobilization of climate finance flows (United Nations, 2023). Also the Bridgetown initiative, presented at COP27, includes proposals for fundamental reforms in these areas. In this context, it is vital that the LDCs' needs, in terms of quantity, quality and access to finance, are reflected not only in the political discourse, but also in negotiation outcomes and their implementation. Announcements made at the Summit for a New Global Financial Pact in June 2023 address key elements of reform of the international financial architecture, including disaster clauses in the World Bank's debt agreements and the rechanneling of SDRs to expand access to finance for the most vulnerable countries. However, these do not go far enough (chapter 5) to break the vicious cycle of shrinking fiscal space, debt build-up and climate disasters in which many LDCs are trapped.

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