



Sustainable Development Goals, structural transformation and financing for development

CHAPTER 1

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A. Introduction

With the world fast approaching the end of the period for implementing the Istanbul Programme of Action and one third of the time elapsed to pursue achievement of the 2030 Agenda for Sustainable Development, LDCs continue to face stark difficulties in reaching their development goals. In this context, taking stock of their dependence on external development finance, a key facet of the development challenges of LDCs, is useful. This issue has long been discussed as both a symptom and a cause of sluggish structural transformation. Such dependence is one reason for international support mechanisms for LDCs. Therefore, analysis of recent developments in the dynamics of volume, sources, motivations and modes of delivery of external finance, and of their impact on the prospects for structural transformation of LDC economies, provides valuable inputs to the process of decision-making on the next 10-year Programme of Action for the Least Developed Countries. Adoption of the next Programme of Action is expected at the forthcoming Fifth United Nations Conference on the Least Developed Countries, in 2021.

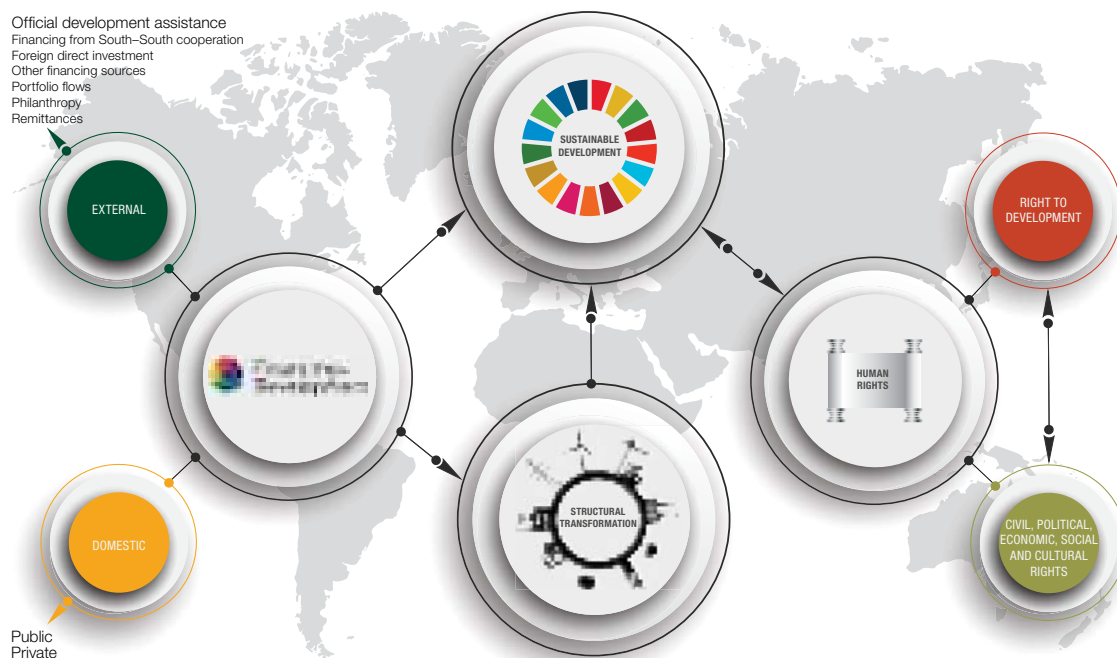
Midway into the implementation of the Istanbul Programme of Action, in 2015, the international community adopted the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda of the Third International Conference on Financing for Development. The Addis Ababa Action Agenda points to vastly expanded financial resources to finance the investment and expenditures required to reach the Sustainable Development Goals. The outcome to date, however, has been disappointing. The required additional financing to be made available to developing countries has not materialized, and total external finance declined by 12 per cent in real terms between 2013 and 2016 (OECD, 2018a). Inflows of FDI to developing countries in 2018 were 3 per cent lower than in 2015, while LDCs suffered a much sharper contraction of FDI inflows, at 37 per cent, over the same period (UNCTAD, 2019a). At the same time, the foreign debt levels of many countries have risen to critical levels. By mid-2019, one third of LDCs were in debt distress or at high risk of debt distress. The challenging financing landscape is compounded by deceleration in world economic growth and world trade, as well as lingering global trade tensions (UNCTAD, 2019b). Together with rapid population growth, environmental degradation and persistent fragility and conflicts, difficulties in financing the development of LDCs could jeopardize the realization of the Sustainable Development Goals.

The outcome of the Addis Ababa Action Agenda for financing resources has been disappointing

This negative external landscape is a major obstacle to sustainable development, given the ongoing strong dependence of LDCs on external resources. Such dependence on external resources to finance development, deriving from the continuous failure of domestic savings to finance these countries' fixed investment needs (see section E), is common to most developing countries, both LDCs and other developing countries (developing countries that are not LDCs). The crucial role of official development assistance (ODA) in development financing is, however, the major specificity of LDCs that renders many of them dependent on this particular external resource. In contrast, other developing countries rely much more on external finance sources other than ODA. At the same time, the landscape of official external finance for development has undergone radical changes in recent years, currently comprising not only ODA, but also financing from sources other than traditional donors. Analysis of changes in the aid architecture and their impacts on the prospects for the structural transformation of LDCs are the central themes of *The Least Developed Countries Report 2019*. The analysis is based on a broader framework that highlights the relationships between financing for development, structural transformation, sustainable development and human rights.

That most developing countries need to access foreign sources or resources to finance their development process has long been recognized in both international development literature and practice (see section D). Current discussions take the form of debates on financing for development (e.g. United Nations, 2019a) or financing for sustainable development (e.g. OECD, 2018a), in the context of the pursuit of the Sustainable Development Goals. The framework adopted by this report adds two crucial components to these discussions. First, structural transformation. As explained in section C of this chapter, *The Least Developed Countries Report* series has shown that structural transformation is a sine qua non for developing countries – and especially LDCs – to reach the Goals. Therefore, structural transformation is the critical link between dependence on external resources and the pursuit of sustainable development. Structural transformation will eventually allow LDCs to escape from their dependence on

Figure 1.1

The relationship between financing, structural transformation, sustainable development and human rights

Source: UNCTAD.

ODA, while allowing them to reach their development goals sustainably.

Second, in this report, the links are recalled between not only dependence of these countries on external resources – particularly ODA – and structural transformation and sustainable development, but also the relationship these have with the elevated goals on human rights. While the pursuit of sustainable development is crucial to realizing the right to development, codified multilaterally in 1986 – long predating the adoption of the 2030 Agenda, realization of the right to development itself, particularly in LDCs, creates an enabling environment for that of economic, social, cultural, civil and political rights. The ultimate goal of mobilizing and allocating development finance is not only to attain sustainable development, but – much more crucially – also to be a means of realizing fundamental human rights. The report thus adds value to ongoing debates and discussions by explaining the economic and logical linkages between dependence on external resources, structural transformation, the Sustainable Development Goals and human rights. For LDCs, undergoing structural economic transformation is ultimately a condition to both escape aid dependence and realize the right to development (figure 1.1). This report thus points out linkages that are usually not made in development

policy discourse and practice, underscoring the importance of structural transformation and human rights to the financing for development–sustainable development relationship.

The motivation and rationale for this report are presented in this chapter. In the next section of the chapter, the relationship between the Sustainable Development Goals of the 2030 Agenda and the realization of human rights are highlighted, which is often neglected in development policy discussions. The main interconnected impediments to the realization of the Goals and human rights, i.e. LDCs' continuing dependence on external finance and the failure of most LDCs to undergo structural economic transformation, are then analysed. In section C, the financing needs entailed by the 2030 Agenda are discussed and the crucial role played by structural economic transformation in achieving the Goals is shown. In section D, external finance is related to the structural transformation of LDC economies. In section E, how LDCs have been performing in the current century is analysed in terms of economic growth, trade, current accounts and structural transformation. The consequences of this for the dynamics of LDCs' dependence on foreign financing are examined in section F. A brief characterization of the changing aid architecture is provided in section G,

while the chapter concludes with section H, presenting the structure of the remainder of the report.

B. Development goals and human rights

Linkages between development finance, structural transformation and human rights are often not highlighted in research and policy discussions, as there tends to be a disconnect in international forums between development and development policy discussions on one side and human rights debates on the other. Some of these linkages are highlighted below.

Both of the main development goal documents relevant to LDCs point to a close relationship between development and human rights. The Istanbul Programme of Action states that “development requires and strengthens... respect for all human rights”, while the 2030 Agenda affirms that “the 17 Sustainable Development Goals and 169 targets... seek to realize the human rights of all”.¹ These documents go beyond commitments to human rights overall in recognizing the right to development. It is one of the principles of the Istanbul Programme of Action, while the 2030 Agenda states that “the new Agenda... is informed by other instruments such as the Declaration on the Right to Development”.²

The link between the Sustainable Development Goals, the Istanbul Programme of Action objectives and the right to development is therefore clear (see box 1.1). First codified multilaterally in 1986 in the United Nations Declaration on the Right to Development, the right to development was later reaffirmed in other multilateral documents (United Nations, 2013). The fact that it has been continuously reaffirmed attests to the importance placed on it by the international community. Many elements of the Declaration (e.g. right to education, health, food) are included in other international treaties and conventions that are legally binding.

The precise nature of the right to development has given rise to continuous debates (Piron, 2002), but it has been established as a human right, distinct from other rights (Pillay, 2013). All human rights are indivisible and interdependent, without hierarchy, as stated by human rights treaties and the Declaration itself. Still, the realization of the right to development creates an enabling environment for the realization of

¹ United Nations, 2011, para. 29 (e); United Nations, 2015a, preamble.

² United Nations, 2011, para. 29 (f); United Nations, 2015a, para. 10.

The human rights perspective is central to some fundamental principles of development policymaking

other fundamental rights, mainly economic, social, cultural, civil and political rights.³

The Declaration prescribes some elements which are key to development policymaking as necessary to the implementation of the right to development, namely the formulation of appropriate national and international development policies and effective international cooperation. Among the duties of States in promoting the right to development is the duty to cooperate with other States to promote the universal realization of the right to development (United Nations, 2013, chap. 1). The Declaration states: “As a complement to the efforts of developing countries, effective international cooperation is essential in providing these countries with appropriate means and facilities to foster their comprehensive development” (United Nations, 1986, article 4.2). Thus, the human rights perspective is central to some fundamental principles of development policymaking. The principle of development partnerships is a long-standing part of international development cooperation practice, and it is at the core of Sustainable Development Goal 17 (and, previously, of Millennium Development Goal 8). Consequently, the human rights dimension permeates the main topics of this report, i.e. international cooperation for development, structural transformation and sustainable development.

In July 2019, the Human Rights Council adopted a resolution with the telling title, “The contribution of development to the enjoyment of all human rights”. The Council called upon “Member States and the United Nations system, including its funds and programmes and specialized agencies, in accordance with their mandates, to mobilize resources to carry out development cooperation and assist States, upon their request, in promoting sustainable development” (United Nations, 2019b, para.10).

International cooperation – which includes ODA – is especially relevant for LDCs. As Sengupta (2013, 82) puts it, “international cooperation is as important as the package of national policies in implementing a

³ As the then President of the Human Rights Council said in 2017, “the fulfilment of the Sustainable Development Goals has a positive impact on human rights. That is to say, greater levels of development can lead towards greater levels of achievement of human rights” (Maza Martelli, 2017).

Box 1.1 Sustainable Development Goals, human rights and the right to development

The 2030 Agenda for Sustainable Development acknowledges that global progress has been uneven, particularly in Africa, LDCs, landlocked developing countries and small island developing States. Realizing the international development policy agenda – including the 2030 Agenda and the Sustainable Development Goals, the Addis Ababa Action Agenda, the Paris Agreement on climate change, the Sendai Framework for Disaster Risk Reduction, and, for LDCs, the Istanbul Programme of Action – requires inclusive, equitable and sustainable development to “leave no one behind” and “reach the furthest behind first”, as pledged in the 2030 Agenda.^a For millions of men, women and children in LDCs, development is an urgent human rights imperative. The Istanbul Programme of Action contains many references to human rights, including the right to development, the right to food, the right to health, sexual and reproductive health, and gender equality and the empowerment of women.

Under Article 1 of the Charter of the United Nations,^b international mechanisms are mandated to promote the economic and social advancement of all peoples and international cooperation in solving problems of an economic, social, cultural or humanitarian nature. Under Article 55, it is stipulated that the United Nations shall promote higher standards of living, full employment and conditions of economic and social progress and development; solutions to international economic, social, health and related problems; international cultural and educational cooperation; and universal respect for, and observance of, human rights and fundamental freedoms. In the Universal Declaration of Human Rights (1948) of the United Nations, under article 1, it is recognized that “all human beings are born free and equal in dignity and rights” and, under article 28, that “everyone is entitled to a social and international order in which the rights and freedoms set forth in the Declaration can be fully realized”.^c All human rights – civil, cultural, economic, political, social and the right to development – are keys to sustainable development and “the right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations”.^d

The 1986 Declaration on the Right to Development provides a holistic paradigm for sustained peace, human rights and sustainable development. Aimed at the constant improvement of human well-being, it makes development a human right of all individuals and peoples without discrimination. The Declaration entitles everyone, everywhere, to participate in, contribute to and enjoy economic, social, cultural and political development, through which all human rights and fundamental freedoms can be fully realized, and to fair distribution of the benefits of development, including income, and equal opportunity in access to basic resources and services. The human person is the central subject of development, should be the active participant and beneficiary of the Declaration and is entitled to free, active and meaningful participation in development, a comprehensive process that advances all human rights and fundamental freedoms.^e

The Declaration on the Right to Development recognizes the right of peoples to self-determination and their right to full sovereignty over all their natural wealth and resources. It affirms that equality of opportunity for development is a prerogative both of nations and of individuals who make up nations.

Good governance at both the national and international levels, shared responsibilities and mutual accountability are all integral to the Declaration, whereby States have obligations to their own populations; to persons outside their jurisdiction who could be affected by their domestic policies; and in their collective role through international and regional organizations.^f

^a United Nations (2015a).

^b United Nations (1945).

^c United Nations (1948).

^d United Nations (1993), annex I, Rio Declaration on Environment and Development, principle 3.

^e United Nations (1986).

^f United Nations (2010a).

strategy for realizing the right to development. It is, perhaps, even more critical in the case of poor and least developed countries”. And, out of all external sources of financing, LDCs as a group are the countries most dependent on ODA (see chapter 1, section F). The volumes, modalities, ways of delivery and allocation of ODA in LDCs, therefore, play a determinant role in the realization of their right to development. If these factors are adequately harnessed, ODA has the potential to be conducive to structural transformation (and, in turn, to the right to development), which has not always been the case (UNCTAD, 2008).

This report adds value to development debates by highlighting the critical role played by structural transformation in the link between financing for development and human rights. On one side, the implementation of an “Aid Effectiveness Agenda 2.0”, as called for in chapter 5, should contribute to the deepening and acceleration of structural transformation, which would thus allow LDCs to eventually escape their current dependence on ODA. On the other side, the attainment of structural transformation is part of the process of achieving sustainable development and, thereby, enables the

realization of the right to development and all other human rights (figure 1.1).

C. Development goals, structural transformation and their financing

Barely four years have gone by since the international community adopted the 2030 Agenda for Sustainable Development. Yet, with little more than 10 years to the 2030 deadline, the mood has shifted markedly. Despite the rhetoric of “leaving no one behind”, rising disengagement has hit LDCs hard, jeopardizing the prospects of achieving the objectives of the Istanbul Programme of Action and the more recent Sustainable Development Goals. LDC stakes in the global economy continue to be marginal, with over 13 per cent of the world’s population and barely 1 per cent of global GDP. Moreover, progress towards meeting the various Sustainable Development Goals targets specific to LDCs has been sluggish at best (UNCTAD, 2018a; UNCTAD, 2019b).

One major reason for the slow pace of progress towards achieving the 2030 Agenda and the subsequent sluggish implementation of the Sustainable Development Goals in LDCs is the international community’s lack of decisive action to make the international environment – including issues of financing for development – in which these countries’ economies evolve more amenable to sustainable development, and the persistence of barriers to the structural transformation of their economies. In this section, the interaction between foreign financing and structural economic transformation is discussed.

The pursuit of the Sustainable Development Goals in developing countries requires heavy investments in economic, social and environmental infrastructure (capital expenditure), as well as raising levels of current expenditure (i.e. operating expenditure). Current expenditure is especially crucial in the areas of health, education and social services. UNCTAD has estimated that, for LDCs, investment needs (i.e. capital expenditure) amount to \$120 billion, annually, between 2015 and 2030, a quantity three times higher than current investment in the Goals, calculated at \$40 billion annually. These capital investment figures include domestic and foreign, as well as public and private, investment (UNCTAD, 2014a).

The question is then how to scale up, mobilize and allocate the funds – not just capital expenditure, but also operating expenditure – required to support the Sustainable Development Goals. Mobilization and allocation of finance to meet the enormous investment

Despite the rhetoric of “leaving no one behind”, rising disengagement has hit LDCs hard

needs of developing countries is a traditional issue in development research and policy (Eaton, 1989; Boussichas and Guillaumont, 2015). The issue of financing for development was already apparent at the time of the Millennium Development Goals and was addressed at the first two International Conferences on Financing for Development in Monterrey (2002) and Doha (2008). However, the issue received relatively little attention from the international community and policymakers, a shortcoming which should have been corrected for the Sustainable Development Goals.

Financing for development is one of the means of implementation of the 2030 Agenda and all the Sustainable Development Goals (along with technology, capacity-building and (international) trade). Going well beyond the corresponding Millennium Development Goal 8 (Develop a Global Partnership for Development), Sustainable Development Goal 17, “Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development” reflects the greater attention given to the means of implementation. Moreover, the international community built consensus on the means of implementation of the Sustainable Development Goals in the outcome document, i.e. the Addis Ababa Action Agenda, of the Third International Conference on Financing for Development.

Though common to many developing economies, the challenge of financing investment and technological upgrading for structural transformation, while maintaining sustainable balance of payments outcomes, assumes particular significance for LDCs.⁴ The sluggish progress in development of the productive capacities of LDCs jeopardizes their ability to reap benefits from integration into global markets, and justifies the special support above and beyond what is granted to other developing economies (UNCTAD, 2016a; United Nations, 2018).

The various Sustainable Development Goals are interwoven, resulting in a complex interrelationship. On

⁴ The 2016 update of the Diagnostic Trade Integration Study of Ethiopia represents a practical example of how the specific challenges of LDCs translate into concrete policy recommendations on the intersection between trade and development finance.

Structural transformation



one hand, there are many synergies among them, and they are mutually supportive, as in the case of poverty eradication (Goal 1) and hunger eradication (Goal 2). On the other hand, the 2030 Agenda also implies trade-offs, e.g. between employment generation and rising productivity (both targets of Goal 8) and between construction of physical infrastructure (Goal 9) and preserving people's settlements (Goal 11) (Basnett and Bhattacharya, 2015). Countries therefore often need to prioritize among Goals, given the limited resources and national circumstances (Donoghue and Khan, 2019). Such prioritization not only takes into account budget constraints, but also allows synergies to emerge in the medium term, by recognizing that striving for certain targets presupposes that others have been realized, e.g. industrial development (Goal 9) and energy supply (Goal 7) (UNCTAD, 2017a).

Budget constraints requiring prioritization among the Sustainable Development Goals exist in all developing countries, but are especially stringent in LDCs. The UNCTAD *The Least Developed Countries Report* series has argued that, beyond mutual support among the three pillars of sustainable development (economic, social and environmental), the crucial condition for LDCs to achieve the Goals is that their economies undergo structural transformation. Structural economic transformation implies the transfer of productive resources (especially labour, capital and land) from low-productivity activities and sectors, to higher-productivity activities and sectors. This requires both the intersectoral transfer of resources (e.g. transfer of labour from agriculture to manufacturing) and intrasectoral progress (i.e. technological upgrading which results in higher productivity, while resources remain in the same

activity sector) (UNCTAD, 2014b). Through rising levels of productivity, countries can attain higher income levels and raise the financial resources (especially from domestic sources) necessary to sustain the spending required for sustainable development, whether capital expenditure or operating expenditure.

Given the interconnection and synergies between the Sustainable Development Goals, all contribute directly or indirectly to structural economic transformation in developing countries and, thus, in LDCs. Some Goals are, however, more directly relevant to structural economic transformation than others, particularly Goals 7, 8, 9 and 12, as are the means of implementation in Goal 17. In view of the critical and enabling role played by these Goals, to achieve higher levels of productivity throughout all sectors of economic activity, investment in the following priority areas is critical:

- (a) Productive infrastructure and facilities, corresponding largely what the Intergovernmental Committee of Experts on Sustainable Development Financing termed “national sustainable development investment financing needs, such as for infrastructure, rural development, adaptation and climate resilient development, and energy” (United Nations, 2014, p. 4);
- (b) Technological upgrading.

Placing particular emphasis on these Goals does not mean neglecting the others. The question is rather one of selecting priorities and sequencing. Selecting these two priority areas leads to employment creation, productivity acceleration and poverty reduction (required to attain Goal 1). This also drives economic growth and higher tax intake for government, which in turn allow for greater spending on the social policies required to achieve the Goals related to social development. This sequencing of policies is necessary in order to give rise to a virtuous circle of sustainable development, which includes positive feedback loops (e.g. between rising domestic demand, economic growth, public and private investment and technological upgrading).

LDCs need significant amounts of external finance to accelerate the process of structural transformation, given the lower levels of development and productivity of these countries. The issue of financing the expenditures required to achieve the Goals is directly related to two structural features of these economies: first, their dependence on external sources of financing and, second, the early stage of structural transformation at which these economies find themselves. This issue and the relationship between these structural features are discussed below.

D. Structural transformation and external finance

While often addressed separately in international development practice, limited availability of development finance and lack of economic diversification exhibit an interdependence long identified in economic theory as challenges that developing countries confront.⁵ The interlinkages between these two facets have been highlighted, spanning from Prebisch's core-periphery models, to the two-gap models popularized by Chenery and the various formulations of Thirlwall's balance of payments constrained models – just to cite the most renowned examples (Prebisch, 1959; Chenery and Bruno, 1962; Thirlwall, 1979 and 2011). Recalling the interlinkages between these two facets of the development process is important before moving into a discussion of LDC dependence on external finance, so as to better contextualize the debate on mobilizing development finance, which has been framed as moving “from billions to trillions” in the post-2015 context (African Development Bank et al., 2015; OECD, 2018a; United Nations, 2019a), and clarify how this debate applies to LDCs.

The interdependence between development finance and current account balances can be explained by examining national account identities, especially the identities between the following: (a) savings on one side and investment and trade balance on the other; and (b) trade balance and net capital flows. These national account identities imply that investment and technological upgrading can be sustained through either domestic savings or external finance, i.e. capital inflows that enable running a deficit of the trade balance (figure 1.2).⁶

As per capita income grows, the equilibrium of the balance of payments is underpinned by a dynamic

⁵ These areas have also traditionally lain at the core of UNCTAD analysis and policy proposals, particularly those related to international liquidity and investment-friendly macroeconomic policy, on the one hand, and trade preference and commodity markets, on the other (UNCTAD, 2014c).

⁶ Leaving aside the government sphere, national accounting identities imply that aggregate income (Y) is equal to consumption (C) plus investment (I) plus net exports (Exp - Imp)

$$Y \equiv C + (\text{Exp} - \text{Imp}) + I$$

This can be rewritten as

$$Y - C - I = (\text{Exp} - \text{Imp})$$

$$\text{Since } S = Y - C \Rightarrow S - I = (\text{Exp} - \text{Imp})$$

This shows that the excess of domestic savings (S) over investment is equal to net exports. In the typical LDC case, the results are negative on both sides of the identity. Therefore, the excess of investment over domestic savings is equal to net imports (i.e. the trade deficit).

The debate on mobilizing development finance has been framed as moving “from billions to trillions”

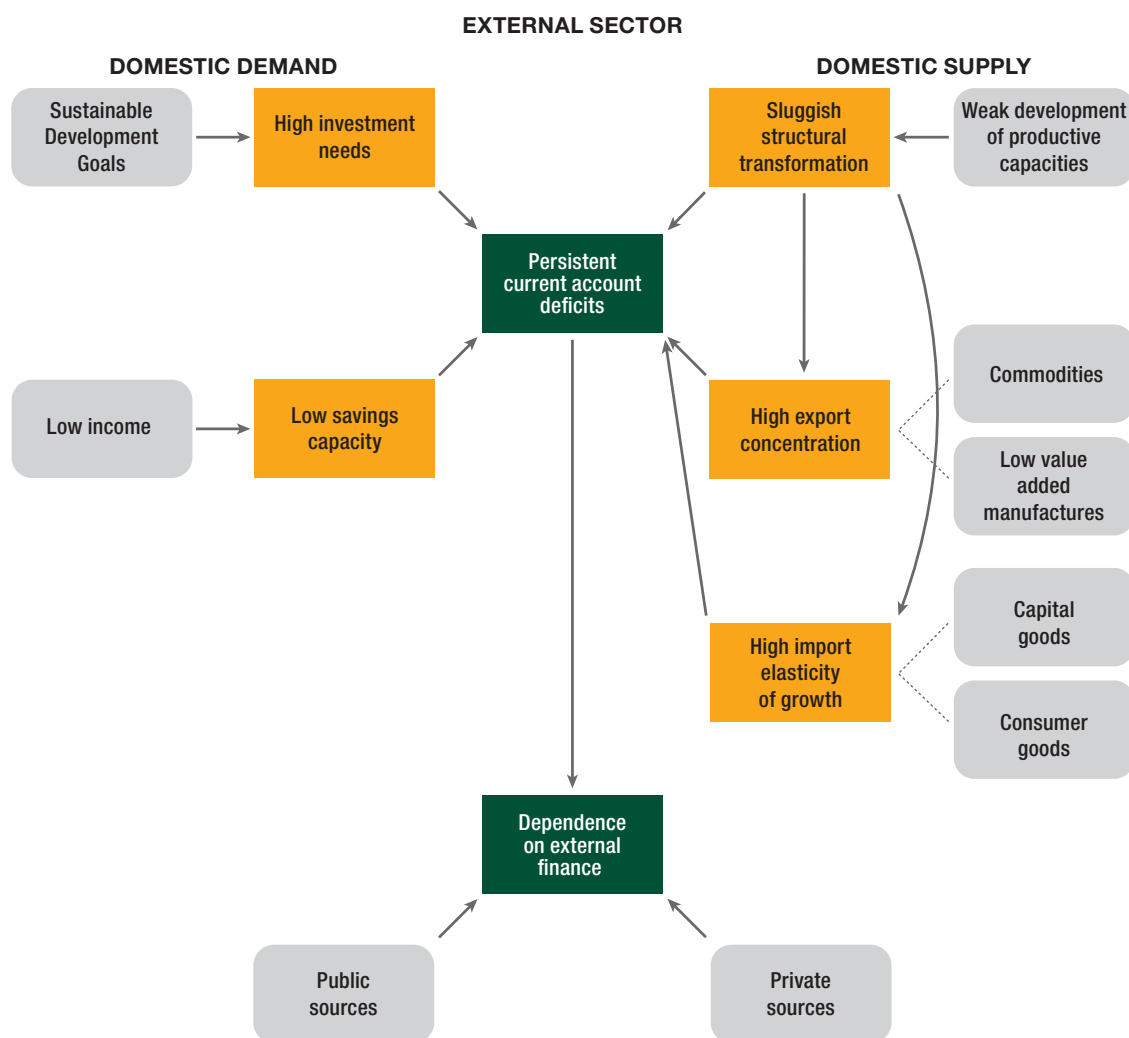
relationship between the expansion of exports and of imports, in turn largely dependent on the sophistication of a country's productive structure relative to the rest of the world. As economic growth takes place, structural transformation ultimately hinges on mutually supportive supply and demand dynamics, which favour the reallocation of resources towards higher productivity activities. This process admittedly has ramifications well beyond international trade, encompassing also the structural change dynamics relevant for domestic production and consumption, particularly in terms of fostering greater integration of rural and urban areas (UNCTAD, 2015a; UNCTAD, 2018b).

From a balance of payments point of view, the reallocation of resources towards higher-productivity activities leads to the expansion and diversification of exports and lower dependence on imported intermediates and capital goods (as domestic firms narrow the competitiveness gap vis-à-vis foreign suppliers). This gradually contributes to the correction of a disequilibrium in the balance of payments through a dynamic export-profit-investment nexus (UNCTAD, 2006a; UNCTAD, 2016b). The development of productive capacities plays a critical role, in this respect, in three different ways. First, it shifts the composition of exports away from primary commodity dependence and towards more dynamic products, i.e. products with a higher growth in demand in international markets that can therefore provide a demand impulse for economic growth in the exporting country. Second, it reduces the income elasticity of demand for imports, i.e. growth of the domestic economy will progressively lead to a smaller increase in imports. Finally, development of productive capacities supports more effective domestic resource mobilization at the public and private levels, which allows for higher levels of public- and private-sector investment.

Proactive exchange rate policies and capital controls can also play a useful role in preserving a stable and competitive real exchange rate, boosting demand for exports. These benefits, however, are contingent on economic and political factors and, in the long run, cannot be the unique driver of industrialization and growth (Frenkel and Rapetti, 2008; UNCTAD, 2016b; UNCTAD, 2018c). Moreover, in general, financing investments made mainly through domestic – rather

Figure 1.2

Structural transformation, external gaps and development finance in the least developed countries



Source: UNCTAD.

than foreign – savings remain the preferable option, often entailing more stable growth dynamics and somewhat greater policy space. This underscores the importance of effective domestic resource mobilization (Cavallo et al., 2018). Yet the option of financing investments through domestic savings is often not feasible at low levels of income, as is the case for LDCs. This is due to the limited scale of domestic resources and ineffective resource mobilization (caused by failings in domestic fiscal and financial systems), as compared to the much larger investment needs of these countries. Additionally, many LDCs suffer from large volumes of illicit financial outflows, which undermine efforts in domestic resource mobilization.⁷

⁷ This issue is discussed further in chapter 4.

E. Economic performance, structural transformation, resources and current account deficits

1. Growth, structural transformation and current account deficits

Though since the global financial crisis of 2008/09, LDCs have mostly maintained a respectable record in economic growth, the pattern of performance has so far failed to redress some of their structural sources of vulnerability. This refers specifically to the heightened reliance on external financial resources for investment and overall negative contribution of trade

to an expansion of aggregate demand. Moreover, even though LDC exports have grown significantly in recent years, this has been accompanied by sluggish performance in structural change, such as the slow expansion of relatively higher productivity activities, notably in the manufacturing sector (UNCTAD, 2018a; UNCTAD, 2019b). In most cases, the pattern of specialization rather is heavily skewed towards primary commodities and manufactures embodying limited domestic value addition, with the associated challenges for the sustainability of long-run growth. These issues – widely discussed in *The Least Developed Countries Report* series and other UNCTAD publications – are outlined in this section, with a discussion on the implications for current account balances at the end.

LDC growth performance since the 2008/09 global financial crisis has been encouraging, albeit generally lower than 7 per cent growth as set out in target 8.1 of Sustainable Development Goal 8. For instance, for LDCs as a group, the average real GDP growth rate was 4.6 per cent during 2011–2017 (2.1 per cent in per capita terms). The uneven global recovery, coupled with weak commodity prices for most of the past decade, have certainly taken a toll compared to the pre-crisis period. As at 2019, seven LDCs are meeting the 7 per cent growth target, roughly half of those at the beginning of the 2000s, while the number of LDCs experiencing a contraction of real GDP per capita is only marginally lower than the peak in 2015–2016 (UNCTAD, 2018a; UNCTAD, 2019b).⁸ Economic growth, moreover, has been mainly underpinned by the expansion of the services sector, including a plethora of traditional (and often informal) consumer-oriented businesses, along with small pockets of relatively higher-productivity activities, such as software development or finance (UNCTAD, 2018b). Dynamism in agriculture and – even more so – manufacturing, in contrast, has been rather subdued, with the contribution of both sectors to growth far lower than that of services. In particular, notwithstanding the expansion in value addition of manufacturing, only a few LDCs have avoided stalled industrialization or even premature deindustrialization⁹ (UNCTAD, 2018a; UNCTAD, 2019b; UNCTAD, 2016b). This sectoral pattern of growth signals the persistent difficulty of stepping up agricultural productivity and generating employment in higher-productivity sectors in a way that reallocates labour to boost economic growth

⁸ Bangladesh, Burkina Faso, Cambodia, Ethiopia, Rwanda, Senegal and South Sudan.

⁹ Defined as a stagnant or declining share of the manufacturing sector in total value added.

Dependence on external resources for capital accumulation



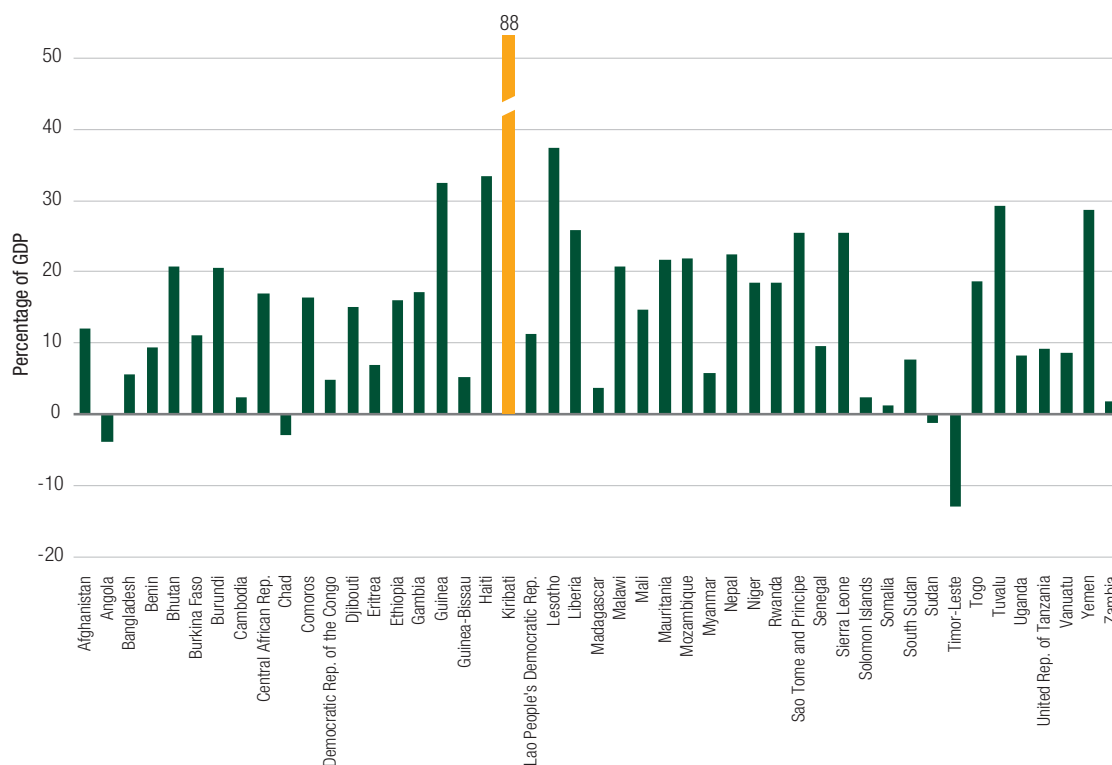
(McMillan et al., 2014; UNCTAD, 2016b; McMillan et al., 2017; UNCTAD, 2018b).

On the demand side, LDCs have achieved relatively high investment ratios (at least since the mid-2000s) but consumption absorbs, on average, 80 per cent of GDP. LDCs have therefore traditionally relied on foreign savings to finance the bulk of their capital accumulation (UNCTAD, 2019b). This dependence has declined only marginally over the last decade, as investment needs remain generally high, whereas domestic savings have expanded sluggishly, constrained by limited purchasing power. In the 2015–2017 period, LDCs' resource gap (defined as the difference between domestic savings and gross fixed capital formation) averaged 8 per cent of GDP. Moreover, only some oil exporters – Angola, Chad, the Sudan and Timor-Leste – were able to escape this pattern of dependence on foreign savings, despite fluctuations in commodity prices and resource revenues (figure 1.3). At the other end of the spectrum, for nearly half of LDCs, the resource gap remained above 15 percentage points of GDP, which is particularly high for small economies and island LDCs.

Another critical consideration in the context of macroeconomic balance is that GDP growth has mostly stemmed from final consumption and, only to a far lesser extent, gross fixed capital formation (figure 1.4). The contribution of gross fixed capital formation, moreover, has shrunk since the global financial crisis of 2008/09, as overall growth slowed while the investment ratio stabilized at around 26–27 per cent of GDP. Perhaps more important, in terms of external finance, is that the contribution to GDP growth of

Figure 1.3

Resource gap in the least developed countries, 2015–2017



Source: UNCTAD calculations, based on data from the UNCTADstat database.

net exports (i.e. exports minus imports) has been negative for most of 2000–2017. This holds true across all subgroups: African LDCs and Haiti, Asian LDCs and island LDCs. The reason is that the dynamism of imports – leakages from the point of view of aggregate demand – exceeded that of exports, resulting in an overall negative effect on growth in aggregate demand.

2. Economic structure and trade performance

The previous analysis does not negate some improvements in LDC trade performance. Despite the challenging international environment, for instance, LDC export revenues (both goods and services) increased at an average rate of 2.7 per cent per year between 2010 and 2017, reaching \$209 billion at the end of the period. Exports of goods have been particularly buoyant for Asian and island LDCs, growing at 7 per cent per year, whereas African LDCs and Haiti have been hit by the heightened volatility of primary commodity prices in the aftermath the global financial crisis of 2008/09. Similarly, although their value is dwarfed by goods exports, exports of services

also displayed a strong vigour, expanding at 7 per cent per year. Taking account of price effects, LDC merchandise exports volumes increased by 80 per cent between 2000 and 2009 and by another 20 per cent between 2009 and 2017.¹⁰

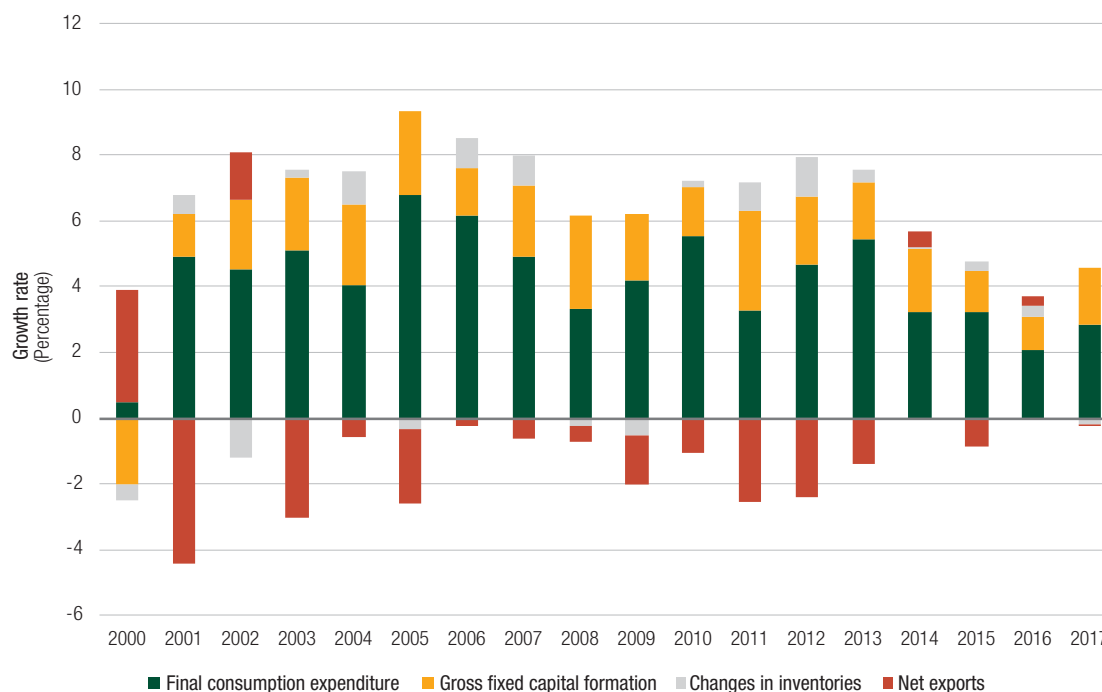
Critically, however, merchandise import volumes grew even more rapidly between 2000 and 2017, expanding by a factor of 3.5, with only a marginal slowdown since 2009. This was spurred by: (a) rapidly growing consumption, especially of goods with a relatively high income elasticity of imports; (b) large investment needs requiring imported capital goods; and (c) demand for imported intermediates in the context of global value chain activities.¹¹ Meanwhile, terms of trade have shown little sign of improvements for the majority of countries, given moderate prices for non-fuel commodities and persistent volatility of oil prices (United Nations, 2019c). Leaving aside cross-country heterogeneity related to the interplay

¹⁰ For a more extensive discussion, see UNCTAD (2019b).

¹¹ Perhaps the best case in point is the use of imported fabrics provided by lead firms in the apparel industry, with LDC firms being engaged only in cut, make and trim services (UNCTAD, 2018b; UNCTAD, 2019c).

Figure 1.4

Contribution to gross domestic product growth, by expenditure in the least developed countries



Source: UNCTAD calculations, based on data from the UNCTADstat database.

between trade flow composition and price dynamics, in general, the result of the trends mentioned above has been a broad widening of trade deficits, in relation to both merchandise and services. Angola has been the only LDC with a trade surplus.

At an equally fundamental level, the expansion of trade flows has largely failed to support a rebalancing of LDC specialization patterns, in particular of the heightened reliance on primary commodities exports and on imported manufactures and capital goods. Of 46 LDCs for which data are available, UNCTAD classifies 39 as commodity dependent, with Bangladesh, Bhutan, Cambodia, Haiti, Nepal and Tuvalu the only exceptions (UNCTAD, 2019d).¹² The extent of primary commodity dependence across the LDCs is such that primary commodities accounted for over 57 per cent of the group's total merchandise exports over 2015–2017, and as much as 69 per cent in the median LDC.¹³ A complementary account of LDC sluggish progress towards export diversification is depicted in figure 1.5, which reflects a median

value across LDCs of the Herfindahl-Hirschmann index of concentration and of the number of exported products.¹⁴ Clearly, in the post-crisis phase, the rise in the number of exported products has largely stalled, with the concentration index also hovering at around 0.4 for most of 2000–2017.

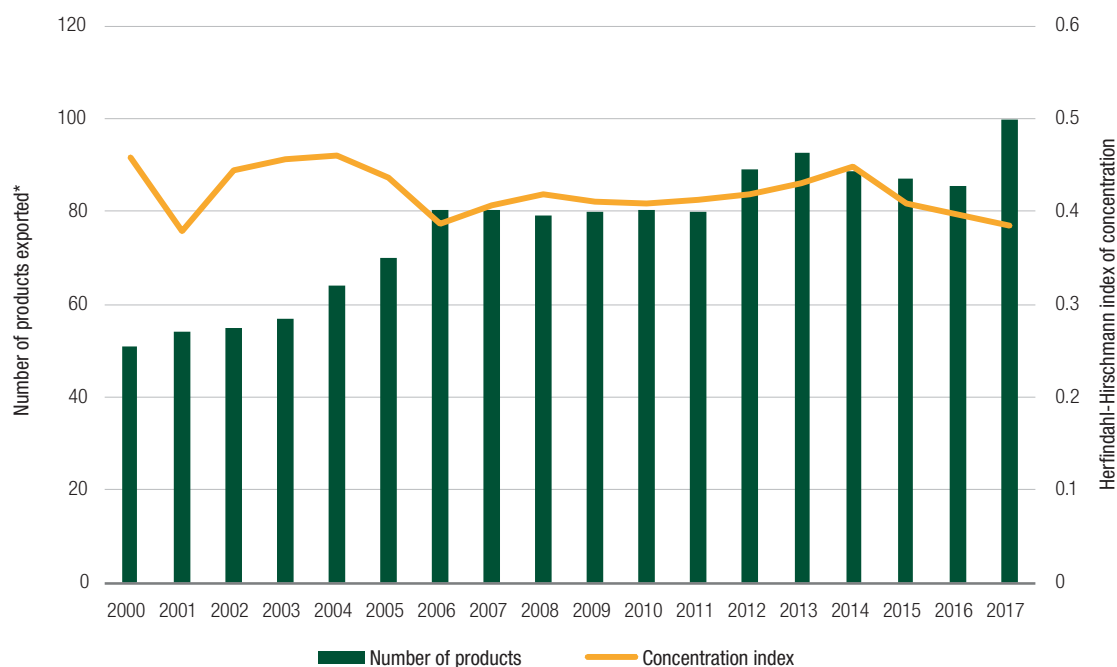
While some visible improvements towards greater export diversification have indeed taken place, especially among East African and South-East Asian LDCs, in general, the pace of structural change remains sluggish, confirming the concerns raised earlier about sectoral contribution to growth. This leaves LDCs dependent on traditional exports with limited income elasticity. The prices of traditional exports are also prone to exogenous fluctuations, with potential adverse effects on macroeconomic policy variables, such as terms of trade, public revenues and GDP. More fundamentally, specialization in

¹² No data are available for South Sudan.

¹³ As smaller LDCs tend to be more heavily dependent on primary commodities, the median value of 69 per cent is also significantly higher than the export-weighted average of LDCs as a group.

¹⁴ Of 260 items categorized based on the Standard International Trade Classification, Revision 3, at the three-digit level. The Herfindahl-Hirschmann index of export concentration is a measure of the degree to which countries are dependent on a few products to generate their exports. The index takes values spanning from 0 to 1, where 1 indicates the maximum level of product concentration of exports.

Figure 1.5

Representative concentration and diversification of export products in a median least developed country

Source: UNCTAD calculations, based on data from the UNCTADstat database.
* Standard International Trade Classification, Revision 3, at the three-digit level.

raw materials and poorly transformed products imply lost opportunities for domestic value addition and, therefore, limited employment generation and dampened scope for productivity-increasing structural change (UNCTAD, 2014b; UNCTAD, 2016b; UNCTAD, 2018b).

In the context of global value chains, moreover, concerns about the nature of LDC export products are compounded by the need to consider also their domestic value added content. Regardless of the final product considered, the scope for productivity spillovers, learning and upgrading is largely contingent on the stages of production that take place within a local economy. This is what provides opportunities for backward and forward linkages, technology transfer and developing productive capabilities. In this respect, there is growing evidence that, though LDC participation in global value chains has increased, this has often been limited to the lowest rungs of the chain, with modest ensuing benefits.¹⁵ In the textile and apparel segment, for instance, LDC firms remain typically confined to simple cut, make and trim activities, while investors' location decisions

are largely dictated by considerations related to preferential trade regimes and market access in key destination markets.¹⁶

These trends call for bold industrial policies (Storm, 2015; UNCTAD, 2016b) and a more balanced focus between “international economic integration” and “domestic integration”, to borrow Rodrik’s phrasing (2018, p. 14). Moreover, they also have direct implications for the balance of payments. For any given exported product, import content and domestic value addition are two sides of the same coin: protracted reliance on imported capital goods, as well as on imported intermediates, essentially weakens the boost in domestic demand deriving from booming exports. This dampens the overall benefit of integrating into a global value chain in terms of balance of payments. From a policy perspective, this means that policymakers need to work with private sector actors along the chain and devise effective ways to harness backward and forward linkages, supporting local embeddedness and enhancing value addition (UNCTAD, 2018b; UNCTAD, 2018c).

¹⁵ United Nations, Economic Commission for Africa (2015a); UNCTAD (2016b); UNCTAD (2018b); Rodrik (2018).

¹⁶ N’Diaye (2010); Staritz and Morris (2013); Morris and Staritz (2017); UNCTAD (2018b); UNCTAD, (2019c).

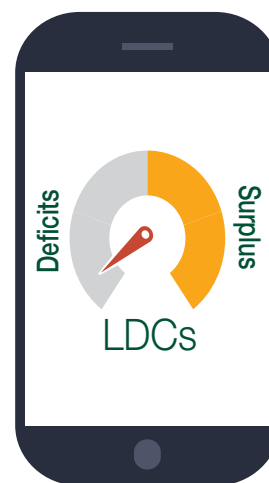
3. Current account trends

As highlighted earlier, LDCs' heightened vulnerabilities and the sluggish progress of their structural transformation are reflected in balance of payments equilibria and largely determine external finance needs (UNCTAD, 2006a; UNCTAD, 2014b; UNCTAD, 2016a).¹⁷ Structural current account deficits have thus been the rule among LDCs, with fuel and mineral exporters or countries receiving transfers and income payments as the main exceptions, as the last 16 years confirm (figure 1.6). LDCs recording a frequent current account surplus included large recipients of workers' remittances (such as Bangladesh, Lesotho and Nepal) and primary commodity exporters (such as Angola, the Democratic Republic of the Congo and Timor-Leste). Several of these countries, however, saw their situation worsen as soon as commodity prices dropped in the aftermath of the global economic crisis. Perhaps more telling in terms of the structural nature of balance of payments constraints is that half of LDCs – including some of the fastest-growing economies, such as Cambodia, Ethiopia and Rwanda – never recorded a current account surplus throughout the period considered.

Beyond the structural nature of current account imbalances, a key issue is that their magnitude has significantly increased in the aftermath of the crisis, to the extent that LDCs' combined deficit rose to nearly \$53 billion in 2017. This amount corresponds to over 5 per cent of the group's GDP and is more than 10 times higher than the average deficit in 2000–2005 (figure 1.7). Moreover, unlike commodity exports windfalls – which led to a short-lived overall surplus for LDCs as a group in 2006–2008 but were concentrated in a few resource-rich countries (see the trend for the representative median LDC) – the widening of current account deficits in the post-crisis period is rather generalized. This is reflected in the representative expansion of the deficit for the median LDC, which fluctuated between 6 and 8 per cent of GDP for most of the post-crisis period. With current account deficits projected to deteriorate further in 2018 and 2019, LDCs' needs for external development finance are likely to widen, even in countries where a flexible exchange rate could in principle help the adjustment process (UNCTAD, 2019b). Amid looming downside risks for the global economy and growing calls to “face the challenge” of mobilizing adequate resources for sustainable development,

¹⁷ It should be noted that the current account balance is determined not only from the trade balance (for goods and services), but also by current transfers – such as workers' remittances – and income payments.

50% of LDCs recorded no current account surplus between 2002 and 2017



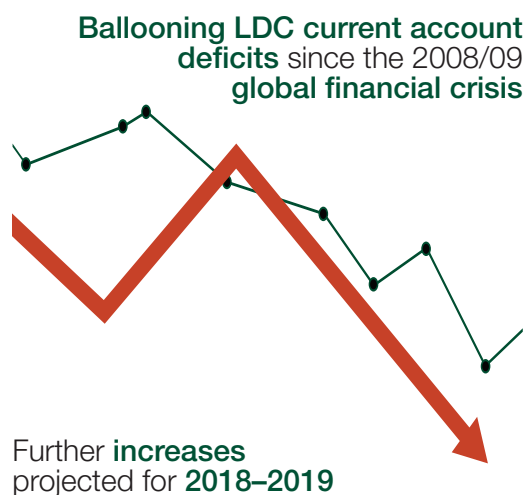
Other LDCs registered mainly sporadic surpluses

meeting these needs and ensuring the availability of sufficient external finance is thus all the more essential to keep the momentum in much-needed investments for sustainable development, and enhance prospects for LDC structural transformation (UNCTAD, 2018d; UNCTAD, 2019b; OECD, 2018a; United Nations, 2019a).

F. Evolution of least developed country dependence on external finance

In light of LDCs' long-standing quest for external finance, and renewed financial needs linked to achieving the 2030 Agenda for Sustainable Development, it is important to take stock of the evolution of the international development finance landscape, assessing how the role of different financial flows has changed over time. Worldwide, the volume of external financial flows to developing countries expanded significantly since the turn of the millennium, but experienced a decline in recent years (OECD, 2018a; UNCTAD, 2018d). Simultaneously, the array of instruments used – from FDI, debt and traditional ODA, to blended finance, remittances and portfolio investment – have continued to increase the potential availability, and complexity, of the development finance landscape.

In the context of balance of payments, FDI, traditional ODA, official financing stemming from South–South

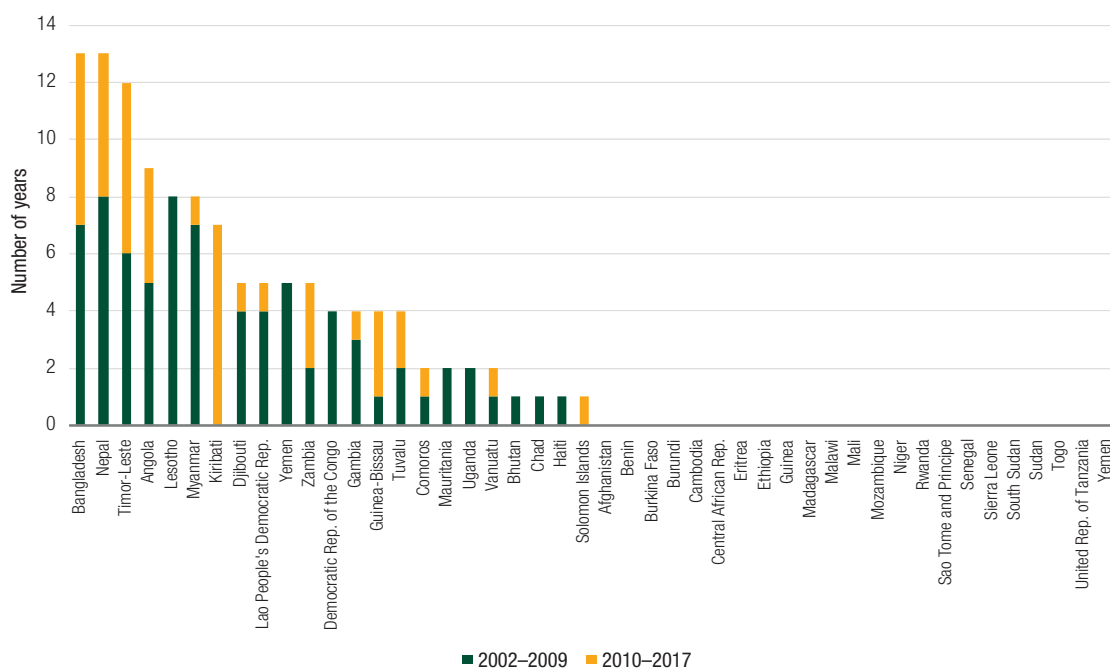


and degree of alignment with each country's structural transformation and development priorities. These characteristics involve, for example, whether resources are public or private, whether they create debt or not and whether they are used mainly for consumption or investment purposes. Questions such as these are crucial in policymaking, as different types of financial resources for development spending can, at best, be imperfect substitutes, and the shift from one type to another may have wide-ranging implications for alignment with each country's development strategies and external indebtedness.

Aid, for instance, does not cut into the corporate profits and household earnings of recipient countries (as domestic taxes do), and it typically adds less to external debt than international borrowing (depending on the grant/loan composition of ODA, as analysed in chapter 2). Aid can be directly allocated to development priorities, unlike remittances, whose developmental impact is indirect and difficult to bring about (UNCTAD, 2012). Moreover, it can be allocated to areas and sectors that are very unlikely to attract the attention of the private commercial sector (whether foreign or domestic), including public goods such as police, justice, national statistics and research, planning and execution capabilities. These different types of financing flows have varying levels of volatility.

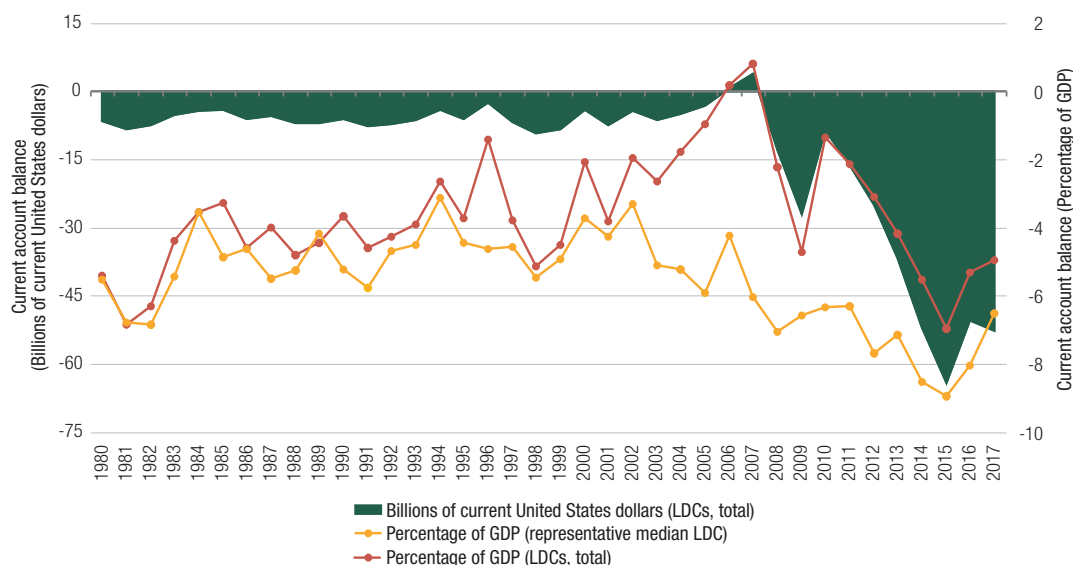
cooperation, remittances, external debt and portfolio investments all represent potential sources of external finance, as do emerging instruments such as the distinct forms of blended finance and public-private partnerships. Globally, FDI and remittances have already exceeded the magnitude of traditional aid resources. Each of these flows, however, has specific characteristics that inevitably shape the extent to which they can contribute to sustainable development, especially in terms of sustainability

Figure 1.6
Number of years with current account surplus



Source: UNCTAD calculations, based on data from the UNCTADstat database.

Figure 1.7
Current account balance in the least developed countries



Source: UNCTAD calculations, based on data from the UNCTADstat database.

Aid is, therefore, potentially the most valuable source of external finance for recipient countries (Kharas et al., 2014).

The availability of external finance to LDCs has increased significantly since the beginning of the century, from \$24 billion in 2000, to \$163 billion in 2017, largely because of the rising weight of remittances, FDI and external debt (figure 1.8).¹⁸ Nonetheless, LDC specificities emerge quite starkly in the composition of external finance. Unlike for other developing countries, ODA remains the most important source of external finance for LDCs, underscoring the challenges in attracting market-based external financial resources.¹⁹ ODA accounted for one third of total external development financing of LDCs in 2014–2017, as compared with just 4.5 per cent for other developing countries. By contrast, the importance of FDI as a source of external finance was the reverse for these two groups of countries. While in LDCs it accounted for one fifth of the total, in other developing countries, it contributed almost half of total external finance. Interestingly, personal remittances had a broadly similar weight for

both country groups: approximately one third of total external finance (figure 1.9).

The importance of ODA for LDCs is further highlighted by the fact that ODA primacy has persisted despite the plateauing of net ODA flows since 2010, and notwithstanding the widening shortfall against internationally agreed commitments, with donor members DAC providing aid to LDCs worth 0.09 per cent of their GNI in 2017, compared to a target of 0.15–0.20 per cent (UNCTAD, 2019b).²⁰

It can be expected that countries that graduate from the LDC status continue to run current account deficits and, therefore, continue to need to tap into foreign savings to finance their development process. However, the composition of external finance is likely to change along that process. Typically, aid dependence recedes and is replaced by other sources of finance, especially domestic taxation and commercial external finance. There tends to be, however, an intermediate phase in which growth is constrained as domestic taxes and foreign private and market-related public borrowing fail to fill the gap left by the loss of access to concessional assistance such as ODA. This is the so-called “missing middle” of development finance (Kharas et al., 2014). Given the prevailing level of aid dependence of LDCs, however, most of them are still far from the situation of the “missing middle”.

¹⁸ It should also be noted that external development finance stemming from South–South cooperation is likely underestimated in these figures, given the difficulties in accessing comparable and reliable data on these financial flows and their attached conditions (e.g. level of concessionality), as discussed in chapter 2.

¹⁹ For instance, LDCs receive barely 1.7 per cent of global FDI inflows.

²⁰ This shortfall is analysed in detail in chapter 2.

Figure 1.8
External finance to the least developed countries



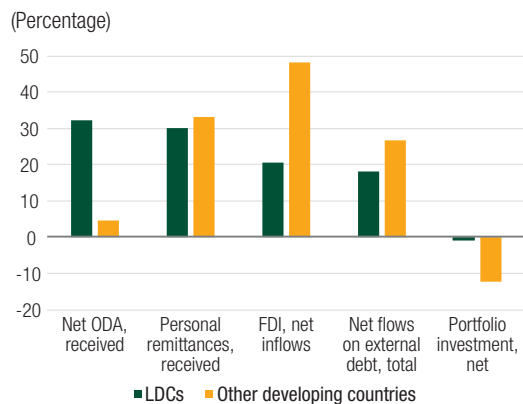
Source: UNCTAD calculations, based on data from the World Development Indicators database.

In line with global upward trends mentioned earlier, remittances have surged to become the second-largest source of external finance for LDCs, reaching a record-high \$42.4 billion in 2017, and have continued to increase despite the recent slowdown in the world economy. They remain, however, private financial flows, typically used more for consumption than for investment. This results in challenges in harnessing their full potential for investments

related to sustainable development and structural transformation (UNCTAD, 2012).

FDI inflows to LDCs also recorded a sharp increase from \$3.9 billion in 2000, to \$37.6 billion in 2015, and receding somewhat since then to \$20.7 billion and \$23.8 billion, respectively, in 2017 and 2018 (UNCTAD, 2019a). Despite the recent decline, the amount of FDI inflows is still six times higher than in 2000. Due to this recent decline in FDI, financial inflows related to external debt have become LDCs' third largest source of external finance. Portfolio investment, by contrast, plays a subdued role and has actually resulted in a net outflow of resources for LDCs for much of the last five years.

Figure 1.9
Share of external development financing, 2014–2017



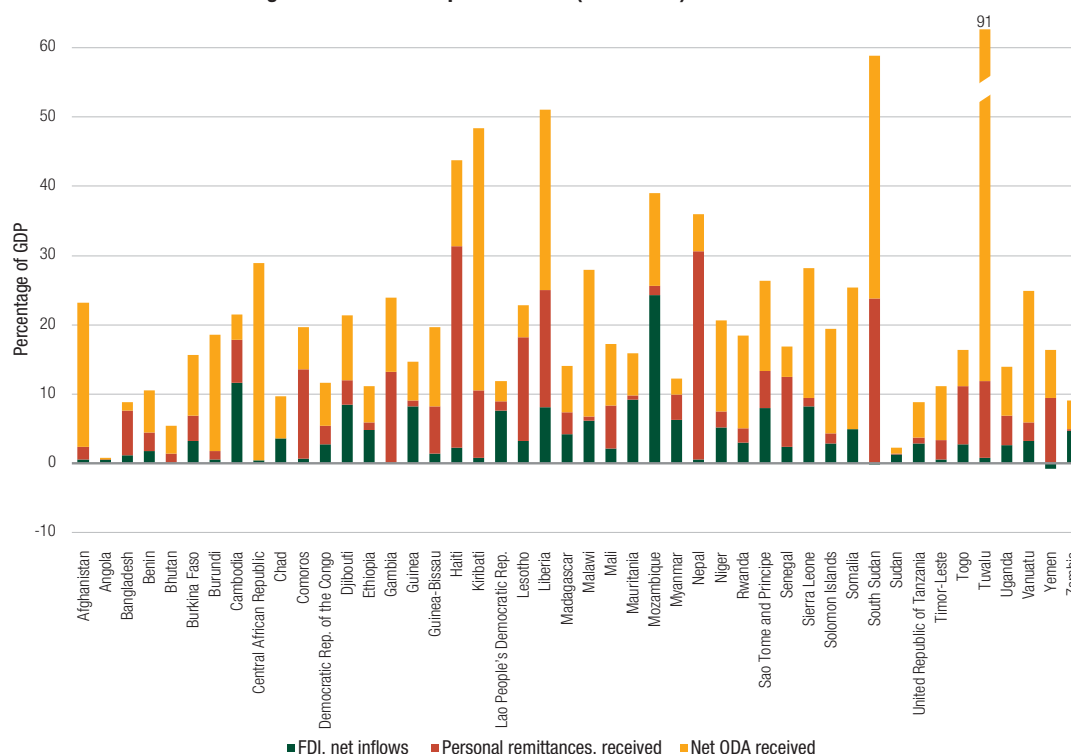
Source: UNCTAD calculations, based on data from the World Development Indicators database (accessed June 2019).

Among LDCs, the significance of ODA relative to other sources of foreign finance is even starker when assessed at an individual country level. This is evident in figure 1.10, which shows the main flows of external finance to individual LDCs, as a share of the recipient country's GDP, averaging values over 2015–2017 to smooth out sharp year-to-year variations. The figure highlights two main features of ODA.

First, regardless of the predominant source, and other things being equal, smaller economies tend to rely more heavily on external finance, as reflected by

Figure 1.10

Main flows of external financing to the least developed countries (2015–2017)



Source: UNCTAD calculations, based on data from the World Development Indicators database.

the higher magnitude of these flows relative to GDP. This has been identified as a source of vulnerability to external economic shocks, particularly in the case of island LDCs, such as Kiribati, Tuvalu and Vanuatu, but also for other LDCs such as Djibouti, the Gambia, Lesotho, Malawi and Sierra Leone, many of which are actually landlocked (McGillivray et al., 2010). Conversely, some relatively larger economies such as Bangladesh, Ethiopia and Myanmar are large recipients of foreign financing but, overall, the weight of these flows does not exceed 10–15 per cent of GDP.

Second, in terms of relative weight of the different sources of external finance, the significance of ODA across most LDCs emerges starkly, not so much because of its overall larger magnitude, but rather, above all, for being more evenly distributed across countries than either remittances or – to an even greater degree – FDI. In other words, ODA is particularly relevant not only for large recipients and “donor darlings”, but also for countries struggling to attract other sources of finance, either due to a small market size that is unappealing to market-seeking FDI, limited resource endowments or the simple fact of not having large migrant stocks abroad.

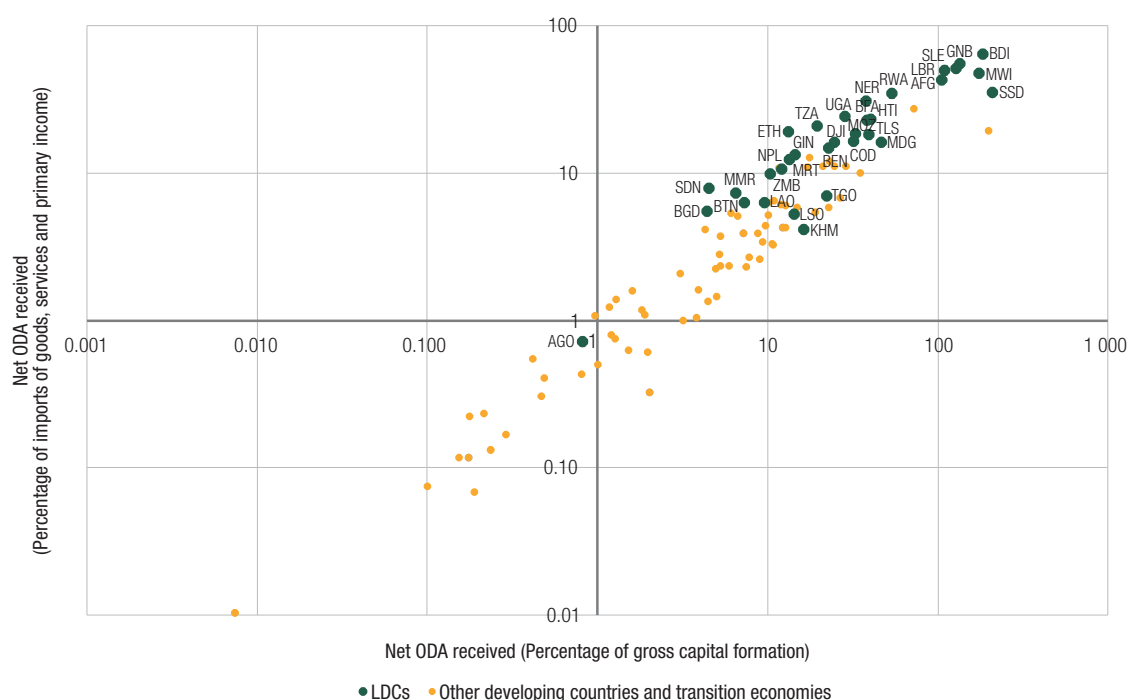
Consistent with the previous discussion on balance of payments constrained growth, further evidence of the specificities of LDCs emerges very clearly from figure 1.11, which juxtaposes the situation of LDCs, other developing countries and transition economies. Averaging over the period 2015–2017, LDCs appear clearly clustered in the top-right corner, with Angola the only exception. This indicates that, by international standards, they are characterized by high net ODA receipts relative to both gross fixed capital formation (horizontal axis) and imports of goods services and primary income (vertical axis).²¹ To complement the visual evidence of figure 1.11, it suffices to note that the median value of the two ratios is, respectively, 25 per cent (horizontal axis) and 16 per cent (vertical axis) in the case of LDCs,

²¹ If anything, LDCs were even further apart from other developing countries in earlier time periods (2010–2012), pointing to the structural nature of their vulnerabilities. It is also interesting to note that outside the group of LDCs, similar levels of aid dependence are essentially found among SIDS (Cabo Verde and Marshall Islands) and economies such as Kosovo (United Nations Administrative Region, Security Council resolution 1244 (1999)) and the State of Palestine.

Figure 1.11

Aid dependence across least developed countries, other developing countries and transition economies, 2015–2017

(Logarithmic scales)



Source: UNCTAD calculations, based on data from the World Development Indicators database (accessed June 2019).

Notes: Both axes are on a logarithmic scale. The four countries recording negative net ODA inflows over 2015–2017 (Argentina, Belarus, China and Malaysia) were dropped to perform the logarithmic transformation. Country names in figure abbreviated using ISO (International Organization for Standardization) codes.

compared to only 5 and 2 per cent, respectively, for other developing countries and transition economies.

LDCs' reliance on external finance, and the persistence of their relative position in terms of aid dependence, points to a continuous need for support, which is widely acknowledged in the Addis Ababa Action Agenda (United Nations, 2015b, para. 52) and within framework of the 2030 Agenda for Sustainable Development (target 17.2). This need has become more acute in recent years, due to the stark changes the international aid architecture has been undergoing, as the next section shows.

G. The changing architecture of aid

The state of LDC aid dependence depicted so far is worrisome in itself. The situation has become even more challenging for LDCs as the aid landscape has changed considerably in recent years. It has become more complex and less transparent since the early 2000s, which further challenges the already constrained capacities of LDC policymakers to

manage the financing of sustainable development in their countries.

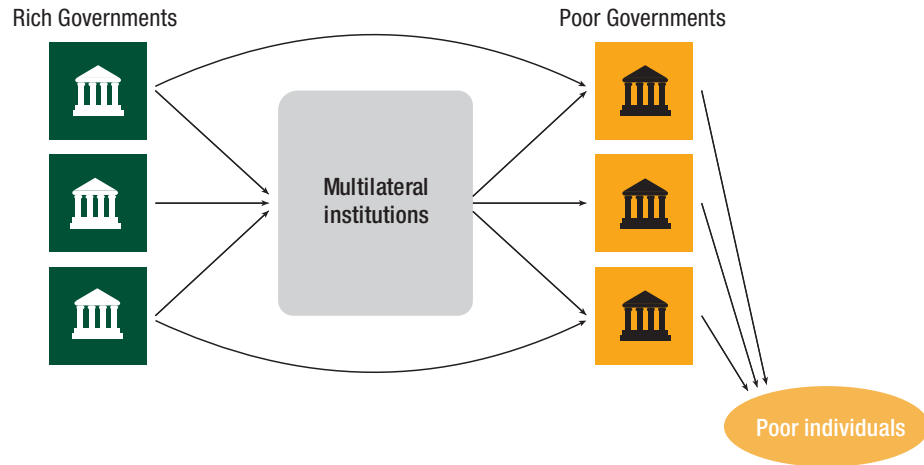
Traditionally, ODA referred to flows of public resources from developed country Governments (donors) to developing country Governments (recipients/beneficiaries) (figure 1.12 (a)). The relationship between donor and beneficiary countries has never been free of controversy, which eventually gave rise to the aid effectiveness agenda (discussed in section B of chapter 5). Nevertheless, the aid architecture was clear, as were the roles of each side.

Over the last 15 years, however, the aid architecture has been transformed, due especially to the following developments:

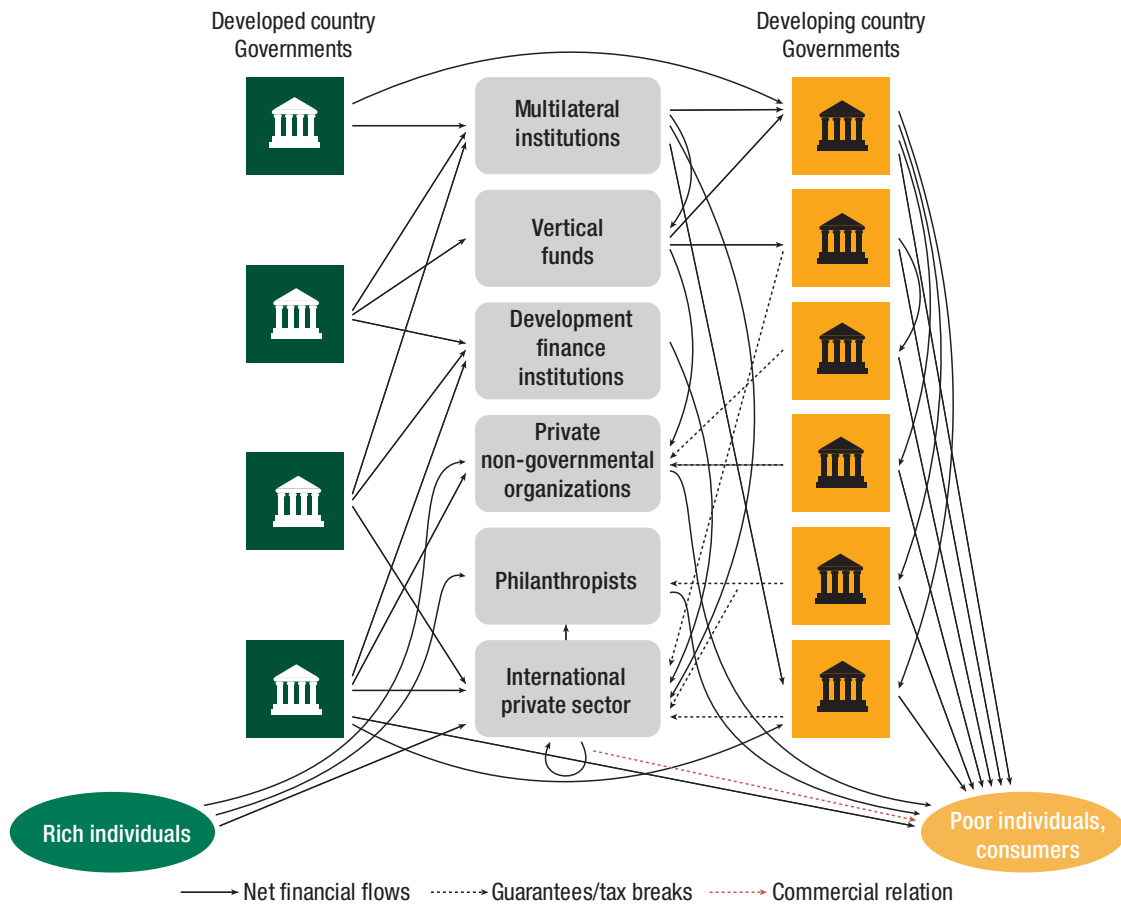
- Changes in the aid policies of traditional donors that affect their aims, priorities, modes of delivery and partnerships. Among other things, this entails the broadening of goals that traditional donors intend to achieve through their aid policies (Severino and Ray, 2009);

Figure 1.12
The changing aid architecture

(a) The old reality of aid



(b) The new reality of aid



Source: UNCTAD, based on Fengler and Kharas (2010).

The global panorama for development financing is becoming more fragmented, complex and opaque

- Shifts in the relative importance of actors, including particularly the changing role of non-governmental organizations and new forms of private sector engagement;
- (Re)emergence of new actors and sources of development finance, especially in relation to the strengthening and broadening of South–South cooperation;
- Entry of philanthropists, who have come to play a major role in some fields (e.g. health);
- Development of new modalities and instruments of raising and delivering aid in the wake of innovations in global financial markets, e.g. blended finance and public–private partnerships.

These crucial developments are transforming the global scene of official development financing, which is becoming far more fragmented, complex and opaque (figure 1.12 (b)). Such changes present challenges to the limited institutional capacities of LDC policymakers and other domestic economic agents. As they strive to mobilize the much higher financing necessary to launch the structural economic transformation required to achieve the Sustainable Development Goals, these changes add to the challenges that LDCs have traditionally faced.

At the same time, these changes provide opportunities, given the possibility of accessing a wider array of sources and modalities of financing. This has been dubbed the “age of choice” for development finance (Prizzon et al., 2016). However, the extent to which the selection of options has widened depends on countries’ creditworthiness. If it is low or lacking, access to private funds on commercial terms in international capital markets (e.g. by emitting bonds) is excluded, or at least more difficult and costly, as an option. Moreover, the very existence of more sources requires carefully weighing the pros and cons of alternative sources and modalities, as well as evaluation of their development impact and the consequences for countries’ foreign indebtedness.

The Monterrey Consensus and the Addis Ababa Action Agenda have reflected these changes by progressively shifting the focus of the international community away from mainly traditional development cooperation, towards encompassing other increasingly visible types of international financial flows and actors.

H. Rationale and structure of the report

Discussions in *The Least Developed Countries Report 2019* consider whether LDC dependence on external development finance poses new challenges for structural transformation in the present era of the Sustainable Development Goals and the changing aid architecture. The research is motivated by two features of LDC development finance in this context. First, the lingering structural high dependence of LDCs on external finance and, more specifically, on ODA. Second, the changing aid architecture, which brings challenges and opportunities to LDCs.

In the report, the extent to which LDCs have been able to benefit from recent changes in the aid architecture mentioned above is gauged. Critically, there is an attempt to assess whether these shifts have resulted in an increase in external finance for development for LDCs and, if this has been the case, whether this increase matches the financing needs of the LDCs arising from the pursuit of the Sustainable Development Goals, in terms of both volume and sectoral allocation. Related to this issue, in the report, analyses are presented of which actors have most influence on the allocation of available financing for development in LDCs and whether this allocation is aligned with LDCs’ development priorities. Ultimately, the research presented in the report is aimed at addressing the question of whether and to what extent available external resources are contributing to the structural economic transformation of LDCs.

The remainder of *The Least Developed Countries Report 2019* is organized around the topics presented here. In chapter 2, the focus is on examining how LDCs’ aid dependence has been evolving recently in terms of sectoral allocation, modalities and instruments, and gauges the consequences (including for external debt). In chapter 3, analyses are presented of how the aid-related elements of the Addis Ababa Action Agenda are being interpreted and implemented in the case of LDCs, and how this has an impact on the changing relationship between the public and private actors in external development finance. In chapter 4, the issues studied are the interaction between dependence on external finance and fiscal policy and how LDC Governments are reacting to the changing circumstances in the international landscape of financing for development. In chapter 5, the policy implications drawn from the preceding chapters are presented. Options are also presented for LDCs to enhance the contribution of aid to structural transformation and, consequently, to sustainable development.

