Tackling structural vulnerabilities and enhancing resilience of LDCs to crisis

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The vulnerability of the LDCs

- LDCs designed as LICs suffering from structural handicaps to development: low level of human capital and high vulnerability
- Vulnerability is the risk to be hurt by exogenous shocks, either natural or external

- The vulnerability considered considered for the identification of the LDCs is only the structural vulnerability, not depending from the present will of the country, and durable
- Resilience or capacity to cope with the shock, as far as it depends on the present will is not considered

The structural vulnerability of LDCs measured by the Economic Vulnerability Index (EVI)

- Designed by the CDP, EVI, set up first in 2000, revised in 2005, captures only structural components of vulnerability, chosen with regard to their expected effect on economic growth

- Transparent and parsimonious, EVI relies on

  - 4 (structural) *exposure* components (pop size, remoteness, export concentration, share of agricultural v.a.)

  - 3 (exogenous) *shock* components, measuring past recurrent shocks, likely to re-occur in the future and still hampering future growth (instability of export, instability of agricultural production, homelessness)

Vulnerability matters, in particular for LDCs

- As evidenced in the literature, exogenous shocks, external or natural, and related instabilities are lowering economic growth

- Beyond short-term effects of negative shocks, all shocks and instabilities have *long-term effects*:
  - they are enhancing risk and are often not reversible,
  - they are also making economic growth less pro-poor, and are factors of social trouble

- The structural vulnerability is a crucial handicap, impacting the LDCs quite beyond the consequences of the recent global crisis

- Also evidenced, structural vulnerability is *higher in LDCs* than in other developing countries and it has been *declining more slowly* during the last decades (see *Ferdi retrospective series*, allowing us to monitor the evolution of EVI and components on a year to year basis)

How vulnerability matters in LDCs…and in view of the IPoA

- To be remembered: for inclusion, EVI is one of the three complementary criteria
- It has not yet a criterion met for graduation (only GNIpc and HAI have been met)
- In view of the goal of reducing by half the number of LDCs: lowering EVI is needed not to meet a graduation criterion (unlikely), but to allow the LDCs to have higher rate of economic growth and cross the GNIpc criterion…

Facing this persistent vulnerability of LDCs, how can it be tackled?

- 2 approaches

- *Increasing the resilience* to the shocks, by tailoring measures to a structural vulnerability taken for granted (shocks and exposure):
  - by ex ante measures: allocating aid according to vulnerability
  - *by ex post* measures: compensatory or countercyclical schemes

- *Lowering the structural vulnerability* itself, by tackling the roots of the handicap,
  - the exposure to the external and natural shocks,
  - and, when possible, the size of these shocks

Increasing resilience
by using EVI as an aid allocation criterion

Proposal: using LDCs identification criteria (GNIpc, HAI and EVI), as aid allocation criteria, more relevant than the overwhelming assessment of policy (usual PBA)

- Higher aid effectiveness (stabilizing impact or higher resilience)
- More equitable (compensation for structural handicaps)
- Better fitting alignment and ownership principles
- Less procyclical and volatile
- Leading to more transparency (fragile states)
- Better assessment of « performance »

Increasing resilience
by better countercyclical support

- Variious experiments either at IMF (CFF, ESF) or EU (Stabex, Flex, V-Flex,…)
- Difficulty to mobilize and disburse fast and efficiently
- However room for improvement, relying on automatic compensation on the basis of previously agreed rules (insurance)
- Among the possible rules, setting up domestic insurance schemes for poor farmers
- Opportunity of a reform of Flex (possibly extended to non ACP LDCs)
- And also need to address instability, not only shortfalls
- Interest and limits of the « countercyclical loans »

Tackling structural economic vulnerability by reducing the size of the shocks

- Can it be obtained in the next decade from a decrease in the *size of the shocks?*
- As for natural shocks, probably no: climate change leads to the opposite
- As for external shocks, it may be, although less specific to LDCs: volatility of commodity prices, a primary concern for the G20
- Excess and failures of the 70s to stabilize prices have led to give up some possible means of stabilisation, more market friendly than those of the 70s

Tackling structural economic vulnerability by promoting diversification

- Concentration of exports, a persistent feature of LDCs, although declining in non oil exporters and in spite of an increasing number of exported products by each LDC
- Diversification, a still fashioned goal, difficult to implement in a competitive way, alone likely to make the country less vulnerable
- Support measures can be effective to promote competitive diversification, besides market access, in particular aid to infrastructure and more generally «aid for trade»
- EIF can also be more focused to the search of the most efficient path to diversification

Tackling structural economic vulnerability by regional integration

- Most of LDCs are of small(population) size, many are landlocked
- Smallness is amajor source of vulnerability
- Concentration and instability of exports significantly lower at the regional level
- Many ways by which external support may favour regional integration: financing transitional costs (losses of duties, institutions) regional infrastructures in transportation and energy
- In spite of declarations, less attention paid than it deserves
- Move from IF to EIF, but always at the country level only. When a REIF?

A last word, on vulnerability to climate change in LDCs and how it can be tackled

- Vulnerability to climate change not taken into account as such in EVI
- Wider and longer term issue than the medium term the vulnerability for growth captured by EVI…
- …although EVI includes some components likely to be influenced by climate change
- An index of physical vulnerability to climate change shows that LDCs are also more vulnerable to climate change than other developing countries
- Followingly, higher needs of resources for adaptation, which can be partly, but logically allocated according to such an index of physical vulnerability to climate change

Economic Vulnerability Index (EVI)

CDP