The vulnerability of LLDCs to external shocks

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External Shocks

- Defined as unexpected and unpredictable events that affect a variable. Comes about when unpredictable change in an exogenous factor impacts endogenous economic variable.
- The unpredictable change and the variable within which the shock occurs are outside of the economic system.
- External shocks are propagated through a complex system of transmission mechanism.
- The risk and impacts of external shocks depends on: a country’s exposure to shocks arising from intrinsic features of the economy (vulnerability) and its ability to withstand or bounce back (resilience).
Vulnerability and Resilience

Vulnerability

Risk of being adversely affected by external shocks

Exposure of a country to external shocks arising from intrinsic features of the economy

- Trade openness
- Export concentration
- Market concentration
- Landlockedness
- Dryland ecology
- Economy size
- Unstable neighbours
- Institutional weaknesses
- Extreme poverty
- Absence of early warning system
- Climate change effects

Resilience

Coping ability enabling the country to withstand or bounce back from external shocks

- Good governance
- Sound macroeconomic
- Market efficiency
- Social cohesion
- Product and market diversification
- Safety nets
- Compensatory mechanism
LLDC’s Vulnerabilities

- Landlockedness, remoteness from major markets
- Small geographical, economic and population sizes
- Colonial legacy; Geographical location; Dryland and mountainous ecology
- Commodities-dependence; Product and market concentration (Exports)
- High # of Neighbors (LLDC have an average of 4.3 neighbors; Global Ave is 2.7. Only 25 out of 239 countries and territories have > 4 neighbors.)
Resilience Challenges

- High incidence of poverty.
- High transport and transaction costs
- Dependence on development assistance
- High external debt
- Inadequate foreign reserve levels
- Low Productivity
- Reliance on remittances
- Institutional deficiency and weak policy formulation
External Shocks: Channels

Multiple Channels

International trade (demand for products and services and supply of factors of production); Private and public capital flows i.e. ODA, Aid for Trade, remittances and FDI; Terms-of-trade and the exchange rate; International interest rates; foreign direct investment; equipment and technology; Policies etc.
Why External Shocks and LLDCs?

- Integration, cross-border trade, and globalization reality: LLDCs’ growth and social well-being tied to global economy
- Shocks are becoming frequent, more destructive
- LLDCs incapable of withstanding shocks by themselves
- Concurrent impacts on LLDCs and partners
- Shocks prevent, reverse growth and development
External Shocks Impacts

- Household - Loss of employment, income + livelihood. Reduce expenditure on food, healthcare and education - reversing MDG gains.
- National Level: Instabilities, compounds landlockedness, limit output, inhibit trade, disrupt integration efforts.
- Factor of production scarcity leads to recessions; impacts investment, future output, productivity and incomes.
- Eliminates social, economic safety nets; undermines resilience; reinforces dependence on aid.
- Creates anxiety, nervousness, and uncertainty which lead to rise in costs, erosion of profit margins.
The 2007/8 Financial and Economic Crisis

GDP Growth Rate (2003-2012)

- LLDCs Percapita growth
- LLDC Growth rate
- World GDP growth rate
3-Year GDP Analysis

- 1/3 had worse contractions than average 34.4%: Armenia, Malawi, Azerbaijan, Macedonia, Botswana, Swaziland, Kyrgyzstan, Moldova, and Niger.
- Transit countries contracted 34.7%.
- 7 countries expanded faster during crisis: Zimbabwe, Chad, Afghanistan, Zambia, CAR, Lesotho, and Laos.
- LLDCs which are LDCs fared better than non-LDCs because of weaker ties advanced economies where shocks began.
Official Development Assistance

- Aid-dependency marked by higher-than-average ODA receipts (% of GNI, central government expenditure, gross capital formation).
- Shocks due to sudden cuts, unpredictability and commitment-disbursement lags.
- In 12 LLDCs, ODA covered about 20% of the central government expenditure (Ethiopia, Afghanistan, Niger, Burkina Faso, Mali, Uganda, Lao PDR, Zambia, Kyrgyzstan, Bhutan, Nepal, Bolivia) between 2003 and 2010.
ODA-Shocks: Consequences

- Delays in project completion, and/or complete abandonment
- Alternative funding arrangement may not be permitted due to contractual obligations
- Abandon reforms, compromise governments’ ability to function, create social unrest
- Violent regime change, especially, following sudden drying up of aid e.g. the collapse of the Soviet bloc
As % gross capital formation is extremely high (>80) for Afghanistan, Burundi, Zimbabwe, Rwanda, CAR and Malawi. Suggests low domestic resource mobilization capacity.

As % of GNI is high (>20) for Afghanistan, Burundi, Rwanda and Malawi. LLDC average is 6%; World is 0.2%.

Aid flows affected by 2007/8 crisis. ODA receipts (% of GNI) fell 16% vs. global decline 2%.

As % of capital formation fell 24.4% vs. global decline 0.9%.
12 LLDCs benefited. As of 2012, eligible LLDCs had received US$ 20 billion (HIPC) and US$ 19 billion (MDRI).

During APoA-decade, external debt % GNI was 51.3% vs. 25.3% for transit countries.

Debt stock for 17 LLDCs around 40% of GNI, many of which are ineligible to benefit from HIPC arrangements.

Debt burden >90% of GNI: Laos, Kyrgyzstan and Kazakhstan.
External Debt-related Shocks

- Most LLDCs have low revenue mobilization capacity, and weak tax recovery mechanism.
- Volatility in the world market impedes ability to service their debt denominated in foreign currencies.
- Forex volatility complicates debt servicing and access to foreign capital.
LLDCs are forced to operate within social and political unrest that may arise outside their borders.

Closes the only route to the sea/world

The 2007/2008 crisis in Kenya: Affected Uganda, Rwanda and Burundi: Caused shortages of consumer products; Uganda's inflation rate rose >10%, daily revenue losses >US$ 600,000; Burundi, which transports > 80% of exports through Kenya great losses due to disruptions.
Libyan crisis created >900,000 refugees, and regional instability.

>420 migrant workers fled into Burkina Faso, Chad, Mali and the Niger.

In 2012, LLDCs with 420 m people (6% global population) had > 1.2 m refugees (12.9% total refugee population of 9.9m)
The Refugee-Burden: UNHCR

Figure 5: Vital Refugees' Statistics for LLDCs (% of Global Total)

- Type of Accommodation
- Total Accommodation
- Reception/transit camp
- Self-settled camp
- Individual accommodation (private)
- Collective center
- Planned/managed camp

- LLDCs Population (% Global)
- Persons in IDP-like situations
- Returned refugees
- Refugees
- Total refugees and people in refugee-like situations
- UNHCR Assisted IDPs protected + IDP-like situations
- Asylum-seekers (pending cases)
Recommendations

Actions by the LLDCs

- Diversification of markets and products
- Economic transformation
- Develop national and household safety nets
- Strong domestic and regional economies
- Alternate routes to sea
- Strengthen governance
Recommendations

Actions by the international community

- Coordinated response to external shocks
- Develop compensatory mechanism
- Establish an international risk insurance
- Strengthen development and humanitarian assistance
- Comprehensively address, on a more sustainable basis, primary and common sources of shocks
Thank You