One common thread that runs across all LDCs is their extreme vulnerability to shocks, including climate change, natural disasters, economic and social disturbances. These shocks severely affect the ability of LDCs to achieve sustainable development and inflict huge financial and other collateral damages to them. Not surprisingly, vulnerability is one of the defining characteristics of LDCs as measured by the Economic Vulnerability Index (EVI), which includes small size and locational disadvantages.

Based on a Resilience and Vulnerability Framework for LDCs, developed by OHRLLS, their resilience has been assessed by analysing the ex-ante capacity of resilience and ex-post time path of the outcome after the shock has occurred, covering various aspects of vulnerabilities.

Idiosyncratic and exogenous shocks affecting the LDCs interact in a complex manner. These shocks have both direct and indirect costs on individuals, households, communities and the economy, all of which could result in crippling long-term effects. For instance, a larger share of the population in LDCs is vulnerable to falling into poverty due to unexpected shocks. Similarly, women are disproportionately affected by shocks due to gender imbalances.

Further, at the macro level, economic vulnerability is closely linked to the structural constraints faced by the LDCs, including small populations and remoteness. Diversifying their economies and building up their productive capacities is key for reducing vulnerability in the medium and long-term.

Emerging shocks—such as climate change and rapid build-up in debt—add to existing shocks and pose several challenges to sustainable development across LDCs. More worrisome, global responses to some of these shocks, in particular to climate change, have not matched the magnitude of the challenges they bring about. For instance, estimates of overall costs of climate change adaptation in LDCs suggest that there is a significant financing shortfall between amounts currently being provided and estimated needs, which runs in the order of billions of US dollars per year.
The increase in debt—with many LDCs in moderate or high debt distress—has increasingly been a cause of serious concern and can have devastating consequences for their economies. This occurs in a context where the sources of finance have become more diverse and complex, bringing with it both challenges and opportunities.

Indeed, recent years have seen the emergence of innovative capital-market based risk financing mechanisms such as catastrophe bonds, contingent credit, and regional catastrophic insurance pools, that can make resources available quickly in case of a shock. Yet, LDCs have had little or no access to such risk transfer mechanisms to date due to their limited ability to pay insurance premiums and other capacity constraints.

In order to reduce vulnerability and enhance resilience in LDCs the following is essential:

• Social protection systems, including cash transfers, are important elements for crisis mitigation and resilience building. To be able to scale up transfers rapidly, it is important to integrate climate and disaster risk considerations into the design and planning of social protection programmes from the start and link them to an established early warning system. To further extend the use of social protection in LDCs, there is a need to strengthen administrative capacity as well as data availability and to involve all stakeholders, especially women, in their design and implementation.

• As the majority of the poor in LDCs live in rural areas, often as smallholder or subsistence farmers, it is important to address their vulnerability to droughts and other weather events. Index insurance can increase the resilience of smallholder farmers, not only through payouts after a shock but also by unlocking opportunities that increase productivity in the non-payout years, for example through access to credit.

• Besides the importance of financial support to the governments of LDCs, transfer of technical and scientific skills is needed to build a viable technological base, which constitutes the backbone of an economic diversification strategy. Investment promotion and improved market access as well as supply side capacity building measures, including through Aid for Trade, need to complement improvements in the business environment of LDCs.

• Macroeconomic policies also need to take external shocks into account, for example through a countercyclical fiscal policy with provisions on financial buffers for “self-insurance” to accumulate adequate resources during booms and to spend them during downturns. In addition, a flexible monetary policy can facilitate and regulate borrowing with a view to improving financial inclusion, preventing speculative activities and supporting productive investment.

• Debt relief, debt moratoriums and debt swaps can be instrumental in releasing resources for reconstruction and the rebuilding of infrastructure. Furthermore, it is important for LDCs and their creditors to incorporate some of the contingencies directly into their sovereign debt contracts, so that when disasters and shocks occur, countries are able to postpone their payments or reduce them during recovery. State-contingent debts link contractual debt service obligations to a predefined variable, such as GDP, can reduce principal and interest payments when the variable declines.

• Efforts must be made to step up climate change finance to LDCs for adaptation, especially for the National Adaptation Plans (NAPs), through the various internationally-established instruments, such as the LDC Fund, the Adaptation Fund and the Green Climate Fund, as well as through bilateral and private sector sources.

• In addition, preparedness for disasters and adaptation to climate change must be factored into national strategies and programmes to implement the SDGs and the IPoA, for example, ensuring that new infrastructure is built to be climate-resilient.

• LDCs need support from development partners, including IFIs, in accessing existing insurance schemes covering external shocks and natural disasters, for example through subsidized premiums. Furthermore, LDCs need support in introducing new insurance schemes at national and regional levels.

• Capacity building support should be strengthened in several areas, including to strengthen social protection and disaster preparedness, to facilitate the preparation of bankable proposals, as well as enhancing absorption capacity. Sharing best practices and lessons learned is vitally important for capacity building and thus a platform for such exchanges among LDCs should be created.

• Access to modern technology and knowledge, as well as up to date information is vitally important for building resilience, including resilient infrastructure, communications and industries. Thus, access to this technology needs to be strengthened. As an example, the Technology Bank for the LDCs will include resilience building in its activities.

• Strengthening support for building resilience should remain a priority for LDCs after graduation from the category, both as part of the smooth transition strategy, as well as beyond, given that they are very likely to remain vulnerable for an extended period of time.

This brief is based on the report: State of the LDCs 2018.

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