Synthesis of emerging trends in economic development

Introduction:

Initiatives that support accelerated economic development are very varied. Some are at the proposal stage while others are poised for scale up. Some have already been proven at scale and need to be further invested in. Some focus on interventions at the household level while others take a macro approach.

The interventions that were selected for this synthesis all have in common the fact that they factor in the recent context of flat aid budgets. They are either time-limited, or can be fused with other sectoral interventions, or finally, focus on the policy side instead of cash outlays.

The recent growth spurt of economic inclusion programs

The State of Economic Inclusion (SEI) 2024[1] unveils a significant increase in the number of economic inclusion programs globally: 405 programs in 88 countries, compared to 219 programs in 75 countries noted in SEI 2021. The global coverage of these programs has also expanded, reaching more than 15 million households and 70 million individuals in 2023, compared to 9.8 million households and 45.8 million individuals in 2020.

Economic inclusion programs are multi-faceted interventions aimed at connecting poor and marginalized households to the economic fabric of their communities. They address the simultaneous constraints or structural barriers faced by poor people at different levels, typically through asset transfers to generate income, income support during the startup period and coaching as well as technical training.

[1] The State of Economic Inclusion Report 2024

Economic inclusion programs help build households' resilience to the normal stressors that people in poverty face (lower revenues than forecasted, illness in the family etc.). The SEI says that they build resilience by "facilitating asset accumulation, income diversification, and access to financial services; and strengthening social networks" (Andrews et al. 2021). Several studies show that households participating in economic inclusion programs were better able to deal with shocks without using damaging coping strategies. Non-participants experienced plummeting well-being due to the impossible choice of reducing an already frugal food consumption or resorting to selling assets, in particular business assets (Bedoya Argüelles et al. 2023; Hernandez et al. 2016; HTSPE 2011; Siddiki et al. 2014; Smith et al. 2019).

The more rigorous sub-set of economic inclusion programs, who insist on incorporating all the intervention components and make a point to target the poor are called graduation programs, because their objective is to put their participants on a self-reliant path to graduate from extreme poverty in three years or less. Dozens of randomized controlled trials have demonstrated that their claims are indeed substantiated with sustained gains is asset building, income generation and food security.

If the growth trend can be sustained to 2029 (i.e. assuming an increase in coverage of 50% every three years), it is 168 million people who would be reached by economic inclusion programs, (i.e. a number equivalent to nearly 30% of people in extreme poverty). However, considering that economic inclusion programs are primarily time-limited interventions, by 2029 a number equivalent to half of the extreme poor will have participated or be participating in economic inclusion programs, with several tens of millions of them already leaving the ranks of the extreme poor and reducing the global extreme poverty count. See The Poverty, Prosperity, and Planet Report 2024; Overview

Agriculture is another area where the World Bank, as well as national governments and other donors, could include an economic inclusion component, for a reduced marginal cost.

Initially, the scale up of economic inclusion programs could take place in middle income countries, where a majority of the extreme poor live[2], and where governments have more ample fiscal means.

[2] Most of the world's extreme poor live in middle income countries – but not for long

Emerging support for low-and-middle income countries (LMICs) to adapt to climate change

Climate change is a challenge for LMICs in many ways:

It creates shocks: floods, droughts and other adverse events brutally upend lives, complicate movements of goods and people, and always end up causing economic harm. They disrupt progress against poverty. Data from the Chronic Poverty Research Centre reminds us how fragile progress is: between 20% and 60% of the people who escaped extreme poverty in six countries fell back within 10 years[3]. Climate events can undo years of economic development. A recent example is the case of the floods in Pakistan.

Climate events are also a shock to the international aid architecture: First, the increased pressures on humanitarian aid can result in reduced funding for long-term development. Such events, especially when they occur in donor countries, can also divert the attention of wealthy countries from overseas to domestic spending (by reducing their own our emissions, donor countries feel they are already doing good for the planet and may feel they do not need to increase their aid budgets as much).

Within aid budgets, an important share of climate financing goes to mitigation projects, which in principle is a good thing but seen from the LMIC perspective, can be construed as a constraint on their path to development to address a problem that they had no part in creating. The feeling of injustice is compounded by the fact that LMICs are paying the biggest climate price because their citizens cannot afford to build dwellings that resist tornadoes, protection walls against water surges or irrigation schemes to supplement failing rains.

There is nonetheless good news: climate funding is increasingly available for emerging markets and developing economies (EMDEs)[4]. Actual funding available is very far from what was promised by donor countries, but if we focus on funding for climate adaptation only, the news is considerably brighter: from 2018 to 2022, global funding has doubled to US$76billion per year. Although adaptation funding would have to triple to meet existing needs, both the level and the rate of growth are promising.[5]

[3] Chronic Poverty Advisory Network, 2014. The Chronic Poverty Report 2014–2015: The road to zero extreme poverty. ODI, page 2, Figure 1
[4] For more details, please refer to ClimateFinance | Home
[5] Global Landscape of Climate Finance 2024 - CPI

Until not so long ago, the environmental community and development community could be seen as two separate worlds, often competing for funding. It is now clear to everyone that, even if the poor are not the ones to lose the most in dollar terms because of climate events, they are the ones for whom the losses are catastrophic, because they have no protection, no plan B and no savings. They will lose school years, access to healthcare etc… So both areas are inextricably connected.

More and more, climate policies are imbedded in the development agenda: over two thirds of economic inclusion projects worldwide have a climate component. Similarly, the World Bank is now devoting 45% of its lending to climate-related projects[6], and several of these projects also have a social component (for instance building tornado-resistant schools and health centres). It is nevertheless clear that climate funding will not fund teachers or iron tablets or birthing centres, so it is key to insist on additionality. More funding for adaptation, should never mean less funding for other sectors.

Addressing liquidity risks associated with climate emergencies

The first financial consequence of climate emergencies is a shock to governments fiscal bottom lines: remedial action requires additional expenditures and, on the other hand, impediments to production and reduced domestic demand yield lower tax revenues.

One interesting initiative launched and recently amplified, by the World Bank is to suspend the repayment of loans during climate emergencies.

Under the World Bank scheme, borrowing countries can postpone repayment of interest and principal for two years. This is not debt forgiveness: interest on the debt accumulates, so the lender is not disadvantaged, but the borrower has enough breathing space to focus on recovery expenditures.

Until the Baku COP 29, the deferral clause only applied to cyclones and earthquakes, but it now also covers all droughts and floods, in addition to health emergencies like pandemics[7]. The clause is available to 45 small economies and 14 of them have availed themselves of the deferral as of December 2024.

[6] COP29 | Climate Finance
[7] World Bank Expands Lifeline to Small States hit by Disasters

A similar Climate Resilient Debt Clause has been implemented by the UK government since 2023, except that if is broader in that it also applies to any low-income country. [8]

Climate Risk Insurance

Debt deferral clauses are useful to generate the fiscal space required to address climate emergencies, but they do not compensate for actual damage incurred. Other mechanisms are required.

Private climate insurance

Microinsurance does not create wealth, but, regardless of where people are on the prosperity spectrum, it avoids reversing the build-up of wealth and negative coping strategies like selling assets, when shocks occur.

Microinsurance functions like traditional insurance, i.e. premiums are charged, and compensation is paid when covered events occur, except that the financial amounts are very small. This means that administrative costs have to kept to a minimum, whether they involve the payment of premiums, the compensation pay-outs, or the assessment of the damage (often the damage itself is not assessed, but a proxy, like rainfall readings in weather stations in cases of floods or drought, is used).

Typically, the clients of microinsurance earn between 2 and 20 dollars per day, so they are not in extreme poverty (if you earn less than 2 dollars you have little to insure, anyway) but if they lose their livelihood, several of them could fall below the poverty line, especially if their sources of income are not diversified.

Despite the administrative challenges associated with microinsurance, and the reluctance of potential clients to pay premiums when take-home incomes are already very low, 116 million agricultural producers are covered through 89 products that include a cover for climate damages in the areas of agriculture, property, business interruption and life insurance. More than three quarters of products addressing climate change were targeting agricultural activities per se. 34 million households, a large majority of them in India, benefit from such insurance products for agricultural damage[9].

A total of 11% of the agriculture schemes surveyed were fully subsidised, the highest proportion of any product line by far. This may offer an interesting experience to draw upon: people with limited income are always reticent to pay

[8] Climate Resilient Debt Clauses - GOV.UK

[9] 2023_Landscape_of_Microinsurance_EN_VF_8ef2acc75c.pdf

insurance premiums for uncertain value, when they face pressing needs that are certain. Extending the coverage of subsidized insurance could present a cost-effective way to prevent food insecurity and income shocks. Further study is required, but at an average of 6% of the amount insured, premiums could be affordable for donors and or national governments, especially at the lower end of the market.

Fund for Loss and Damages

While private insurance is important and has much potential for scale up, a solution at the state-level would be more systematic: indeed, climate events (and natural disasters) do not only impact agriculture but the entire economy. This is why the international community came up with the concept of a Fund for Loss and Damages. The Fund was created at COP 27[10] and made operational in 2024[11] by appointing a secretariat and a team leader to head it.

The problem, as with most climate finance, lies with funding: less than US$800 million has been mobilized so far, which is very far from covering the needs so far. It is still early in the process, so it will be important to wait until at least the next COP in Belem to pass judgment.

Trends in trade: sharing in global growth?

If funding from donor countries is reaching a plateau, perhaps global trade and its ever-increasing volume might offer a more promising avenue for low-and-middle countries.

There is no denying that trade plays an important role in economic development. Long thought as an impediment to development of the poorest, the tide appears to have turned.

Earlier, international trade was associated with the local elites (purchasing luxury food items or cars, for instance) while much of what the ultra-poor were consuming was produced in their regions. It was also seen as undermining local industries that did not have the resources to compete with technology-intensive products from higher income countries. Finally, the needs of the poorest (basic water pumps, teachers, front-line health personnel) did not appear to require importing.

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[10] Loss and Damage Fund: Board Nominations, Pledge Tracker, and COP28 Insights – Loss & Damage Forum

[11] Historic Decision in Baku: The Loss and Damage Fund fully operationalised

This was of course an oversimplification. In reality, the ubiquitous nature of electronics and informatics, and later during the COVID-19, the clear need for sophisticated vaccines and medical products that would largely not be produced locally under any scenario, made clear that global trade was not only unavoidable but certainly, in many respects, desirable. Soon thereafter, the food and fertilizer crisis only confirmed this conclusion.

In fact, the World Trade Report for 2024 demonstrates that over the past 30 years, trade has increased growth and reduced poverty[12].

What is perhaps more surprising is that the poor and the wealthier strata tend to benefit in similar proportions from trade. This does not mean that the distributional impact is neutral: some people fare better than others. This means that nations engaging in trade must put in place the proper mechanisms for redistribution of the benefits through social programs and/or taxation.

Global trade may however have started to face headwinds. The findings of WTO Trade Monitoring Report 2023[13] explain that, while between mid-October 2022 and mid-October 2023, WTO Members introduced more trade-facilitating than trade-restrictive measures on goods, the pace of implementation of new export restrictions by WTO Members has increased significantly since 2020; although some of these have been rolled back, as of mid-October 2023, 75 export restrictions on food, feed and fertilizers were still in place globally, in addition to 20 COVID-19-related export restrictions.

As a result, annual growth for 2024 is estimated at 0% for exports and 2% for imports in all developing countries outside of East Asia.

The future may be starker. The Trade and Development Report 2024 by UNCTAD shows that South America, Africa, South Asia and East Asia all have high tariffs on US goods and services, with South Asia, East Asia and the richest countries of Africa also running a trade surplus with the US. This makes these regions more exposed to increased tariffs from the US.

In this context, it is at least comforting to know that South-South trade is forecast to increase by 4%.

If the volume of trade cannot be expected to grow significantly, the gains from trade can be enhanced by implementing complementary policies.

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[12] https://www.wto.org/english/res_e/booksp_e/wtr24_e/wtr24_e.pdf

[13] World Trade Report 2023 | WTO iLibrary

A) Adequately training local personnel to improve the competitiveness of the export sector.
B) Developing value chains so not only the raw materials are developed but also processed resources.
C) Put in place a resource royalty and taxation system that is equitable for the national government while not being a deterrent to risk-taking for investors.

All these complementary measures require considerable technical assistance. Canada is well positioned to provide support and in the specific area of negotiating benefits from resource development, so are Canadian Indigenous groups who have decades of experience implementing impact benefit agreements.

Pathways toward a fairer economic system

Making Financing Affordable

Official Development Assistance will not only be limited in the coming years, but a lot may be directed to the reconstruction of Gaza, Lebanon and Ukraine. Fortunately, there are other sources of funding emerging, alongside ODA. In recent years, loans have increasingly been used by LMICs.

The problem is that with the generalized increase in interest rates, the loans contracted by LMICs suddenly became unaffordable. Servicing debt was creating severe fiscal constraints for many LMICs. The situation stabilized itself in 2023 and 2024 with lenders, especially private sector and bilateral ones, ceasing to offer new loans. As mentioned in the World Bank Chief Economist's report[14] , at the end of 2024, one of the consequences is that there has been no positive net private investment in Africa since 2019, despite expanding needs resulting from inflation, polycrises and population growth.

In other words, the world averted a systemic debt crisis at the cost of economic development. It is more urgent than ever to explore avenues to increase the supply of affordable loans. There are three solutions that are worth pursuing.

1) *The multilateral development bank (MDB) capital adequacy framework agenda*

[14] https://openknowledge.worldbank.org/bitstreams/4246aa14-dffa-415d-a7e8-fa102165a5fa/download

The MDBs recognize that there is 300-400 billion dollars in additional lending that could be freed up in the decade ahead[15] if a number of painless measures were taken. Several of the measures have been adopted in principle already. The problems is that donor countries must now encourage conservative-minded MDBs to act and actually issue more loans.

2) *The proposed G20 Capital Cost Commission*

African countries are paying huge interest costs on their loans, amounts that are unjustifiable from a financial perspective. Indeed, one analysis concludes that the cost of capital is 500% of what it would otherwise be if countries borrowed from IBRD, the branch of the World Bank that lends to middle-income countries[16]. The issue is that the interest costs bear no connection to what the actual credit risk is. It is a cost imposed by markets based on fear and lack of information. Both factors are manageable: fear can be addressed by risk-sharing mechanisms, and lack of information can be addressed by more transparency and dialogue with credit rating agencies and potential creditors.

This is why South Africa announced that it would make the cost of capital a key element of its 2025 G20 presidency[i17]. One of the examples that might be replicated on a larger scale is the recent refinancing operation in Cote d'Ivoire. Faced with an unaffordable loan, Cote d'Ivoire took a longer term loan on more favourable terms from a private sector lender on the basis of a guarantee provided by the World Bank. It then reimbursed the unaffordable loan and agreed to invest the savings in the education sector[18]. For a more complete view of the issues that the Capital Cost Commission might deal with, please refer to the proposal put forward by South Africa's leading think tank[19].

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[15] World Bank Announces Historic Collaboration Between Multilateral Development Banks

[16] The collateral damage of rising interest rates - ONE Data & Analysis

[17] In bid to address Africa's high debt burden, SA proposes Cost of Capital Commission

[18] https://www.worldbank.org/en/news/press-release/2024/12/05/c-te-d-ivoire-s-debt-for-development-swap-enabled-by-the-world-bank-group-will-free-up-funds-for-education

[19] Copy of Policy Note 1

3) Continuing to re-channel SDRs

An issuance of SDRs worth US$650 billion was concluded in 2021. Because the SDR receipts were a function of the size of a country's economy, over US$400 billion in SDRs went to wealthy countries, who have no need for it, because SDRs are an international currency, and wealthy countries all have ample foreign currency reserves. Poorer countries, in contrast, need the currency to import goods and services. Fortunately, there are mechanisms to re-channel SDRs to poorer countries, who borrow them at low or no interest rates, while wealthier lenders do not incur any cost.

The mechanism has been in operation for several years and 25% of the advanced economies' SDRs have been rechannelled, with no negative consequences[20]. A further tranche of 25% would immediately free up an additional $100 billion in affordable lending, at no cost to the rechannelling countries.

Conclusion

The various trends in global cooperation show a diversity of pathways to support economic development.

Some will require infusions of funds. Scaling up the economic inclusion programs is a case in point, but the programs have two big advantages: they are time-limited and have a proven track record in abating poverty. Climate adaptation funding will require new funding, but like economic inclusion, it plays an important role in preserving incomes in rural areas where 80% of the extreme poverty burden is concentrated, and it can be integrated in other programming such a food security or social protection.

At the other end of the spectrum, measures like the G20 Cost of Capital Commission, technical assistance for resource revenue mobilisation and the expansion of SDR rechannelling involve minimal expenditures by donors. And in the middle sit the various insurance initiatives where the cost of expanded coverage still requires further exploration.

Considering the hurdles facing LMICs and the slow progress in ending extreme poverty, all the initiatives should be pursued (they are largely self-reinforcing) instead of waiting for an elusive silver bullet.

[20] Data Dive: Special Drawing Rights - ONE Data & Analysis