FONDATION POUR LES ÉTUDES ET RECHERCHES SUR LE DÉVELOPPEMENT INTERNATIONAL

Impact of support measures to the least developed countries (II). Conclusions of *Out of the trap*

Patrick Guillaumont

Patrick Guillaumont est Président de la Ferdi.
Contact : patrick.guillaumont@ferdi.fr

Out of the trap[1] assesses the impact of the least developed countries category membership on the development of these countries. It is a companion volume of *Caught in a trap*, which assessed the rationale of the category and the way member countries are identified. Assessing the impact of LDC status is difficult because there is no adequate control group. Countries benefitting from support measures linked to LDC status are also countries suffering most from structural handicaps. And not only has the perimeter of the category changed over time, so have the strength and coverage of the support measures, and their effect may have been progressive, or even delayed.

… /…

1. Guillaumont, P., *Out of the trap. Supporting the least developed countries*. Economica-Ferdi, 2019, 324p., (Authors: Arcand J-L, Audiguier C., Boussichas M., Brunelin S., Carrère C., Chauvet L., Cortez A-L,. Drabo A., Feindouno S., Goujon M., Guillaumont P. (Edr), Jeanneney Guillaumont S., Kilama E., Korachais C., Lenzi T., de Melo J., Mollerus R., Wagner L.).

policy brief
197
December
2019
note brève

.../... *Out of the trap* assesses the impact of the least developed countries category membership on the development of these countries. It is a companion of *Caught in a trap*, which assessed the rationale for the category and the way member countries are identified. Assessing the impact of LDC status is difficult because there is no adequate control group. Countries benefitting from support measures linked to LDC status are also countries suffering most from structural handicaps. And not only has the perimeter of the category changed over time, so have the strength and coverage of the support measures, and their effect may have been progressive, or even delayed.

In the last quarter century, opinions on LDCs issues have themselves been evolving. When the project for these twin books was launched, the rationale for the category was paradoxically underestimated, and its effectiveness overestimated. Since that time the category's legitimacy has been enhanced, as have the support measures.

This book's eight chapters examine the effectiveness of international support measures to LDCs. Their conclusions are summarized here, underlining that the future effectiveness of the support measures is linked to the consistency of the category, still to be enhanced.

► Economic growth, poverty reduction and structural transformation in the least developed countries: The puzzle of the impact of category membership

The analysis in chapter 1 does not reject the hypothesis that LDCs were initially caught in a low-income trap: The structural handicaps of LDCs did reduce their economic growth, but more over 1975-2000 than over 1975-2011, suggesting some structural change since the beginning of the millennium.

Since the mid-1990s and accelerating in the 2000s, economic growth in LDCs improved after two decades of low growth, holding out hope that escape from the trap was possible. On average, LDCs are now growing as fast as other developing countries. But convergence in income growth does not mean convergence in income level, which requires faster GDP per capita growth in countries with lower incomes.

During the nearly five decades since the LDC category was established, LDCs have reduced poverty and implemented structural changes, as reflected in improvements in the two indicators of structural handicaps used to identify LDCs: the Economic Vulnerability Index and, even more clearly, the Human Assets Index. But the gap between LDCs and other developing countries has narrowed little, suggesting that LDCs continue to face more severe obstacles to growth. The gap in economic vulnerability has even been widening recently. Poverty reduction, while substantial, has been slower in LDCs than in other developing countries, due both to slower growth of income per capita and to a weaker response of poverty to economic growth.

Structural transformation, as reflected by the change in the economy's sectoral composition, has largely occurred through an increase in the service sector's share of the economy (to about half) and a decline in agriculture's, with little change in industry's. Average productivity growth in LDCs seems to have come mainly from within-sector changes, particularly in agriculture, rather than from a sectoral shift in the labour force.

Oil resources seems to explain only a small share of the improvement in LDCs. Changes in the terms of trade reduced economic growth in both LDCs and other developing countries before 2000 and increased it over 2000-15. The contribution of changes in the terms of trade was larger in LDCs than in other developing countries, so that improvements narrowed the growth gap between LDCs and other developing countries. Moreover, LDCs were relatively more protected from the global economic crisis of 2007–09 than were more developed countries - partly because they are less integrated into the global economy - and they experienced a smaller decline in external capital flows (remittances, development assistance and foreign direct investment).

It is likely that the persistence and reinforcement of external support contributed to the improvements in LDCs. But the analysis here could not rigorously measure the impact of that support on the overall performance of LDCs in economic growth, poverty reduction and structural transformation. The reason: countries benefitting from these support measures are at the same time facing specific structural handicaps (by definition). It was not possible to disentangle the impact of the handicaps, which vary among LDCs, from that of the support measures to overcome them.

The analytical methods (including regression discontinuity design) did not reveal a causal effect of LDC status on economic growth in the short run. But the overall long period trend improvement makes likely that support measures had a positive impact, although progressive or delayed. The following chapters consider the support measures separately, along with their country-specific application, which allows for better assessment.

Policy performance: Is it weaker in the least developed countries?

Developing country economic policies and institutional quality are a major factor of economic growth. Countries lagging the furthest behind - the LDCs-seemed also to be those suffering from the poorest policy performance among groups of developing countries. Chapter 2 questions how performance is used, arguing that it is often defined too simply, and then wrongly. A more appropriate definition controls for the structural factors featuring LDCs - Income per capita, economic vulnerability and human capital - Given that they are likely to be inversely related with performance.

The chapter presents the results of an econometric analysis of cross-section and panel data that strongly support this assumption. Specifically, once human capital and economic vulnerability as well as the level of income per capita were taken into account, the gap in policy performance between LDCs and non-LDCs - measured either by the World Bank governance indicators or by specific policy outcomes - became insignificant. Even so, it does not seem that the policy performance of LDCs, as captured by these adjusted measures, significantly improved during the last two decades compared with other developing countries so that it could be the main explanation of the growth gap reversal.

That the economic vulnerability and governance indicators are inversely related, especially after controlling for income per capita, provides a strong case for augmenting the performance-based allocation mechanisms of the multilateral development banks with appropriate measures of structural vulnerability.

Global aid flows to the least developed countries: What effectiveness of the aid target?

The level of aid LDCs receive as a share of their GDP is significantly higher on average than in other developing countries. Their aid per capita is also higher, but to less extent since their GDP per capita is lower. The level they receive per poor person is no longer clearly higher, since the percentage of poor people (the headcount poverty ratio) is higher.

From the beginning of the LDC category, development assistance has been seen as a major tool to support the LDC effort to move out of the trap. The legitimacy of giving priority to LDCs in aid allocations is well established, relying both on equity reasons (equalizing opportunities by addressing the structural handicaps featuring the category) and on effectiveness reasons (marginally higher in more vulnerable countries). This legitimacy has been formally recognized by the international community through specific ODA targets for LDCs (as a percent of gross national income), as well as by the UN General Assembly invitation to use LDCs identification criteria as criteria for aid allocations[2].

However, the actual flows of official development assistance (ODA) to LDCs have remained far below the targets, and the allocation between countries far from what it would have been according to the LDCs identification criteria. This does not mean that ODA to LDCs has been ineffective in supporting the LDCs development, but it suggests that reaching the targets could have resulted in faster growth and development. With a higher level and a better design of ODA to LDCs, a larger number of them could have graduated from the category and seen their following needs of assistance declining. The remaining LDCs could then have received more aid on average (for a global level of aid to LDCs) and become better prepared for graduation.

Multilateral assistance to the least developed countries: To what extent is it specific?

The LDC category has been useful to gather political support within intergovernmental negotiations as witnessed by the references to their special situation in numerous development agendas and outcomes, including the 2030 Agenda for sustainable development. It can also be argued that, thanks to the creation of the category and political support over the years, the overall share of multilateral ODA received by LDCs is significantly higher than what would otherwise have been the case.

With their activities, UN organizations make significant contributions in various degrees to the development efforts in many LDCs. But while the UN entities recognize the LDC category, such recognition does not translate into a consistent application of priorities and budget allocation, and variations are large in the type and level of LDC specific assistance. While the mandate of some specialized agencies may not closely relate to LDCs, this is a concern for UN agencies whose primary objective and mission is to promote sustainable development. Overall, it is essential that UN organizations go beyond the mere recognition of the LDC category and provide access to meaningful LDC-specific support measures. Too often, assistance is based on UN organizations' own criteria, which may not be related to the LDC status.

There is also a need to articulate more tailored, national and international responses for each LDC – to make support measures more effective and more targeted to country needs.

The total multilateral resources allocated through UN channels is lower than that allocated through international financial institutions. Although the non-recognition of the LDC category by these institutions does not translate into an absence of activities or funds disbursed to LDCs, the lack of formal LDC-specific support may result in some LDCs being consistently left out as beneficiaries.

To equitably address the specific issues facing LDCs due to their structural handicaps, multilateral ODA, channelled either through the United Nations or the multilateral financial institutions, should take into account the UN General Assembly resolution on a smooth transition from the LDC category inviting development partners

2. General Assembly Resolution A/RES/67/221 (paragraph 23) on "Smooth transition for countries graduating from the list of least developed countries" adopted on 21 December 2012.

to consider the LDC indicators – gross national income, the human assets index and the economic vulnerability index – as part of their criteria for allocating ODA, as the European Union has already done. While this resolution applies to all development partners, it matters particularly for multilateral institutions and among them the UN organizations, which could take the lead in addressing the LDC concerns. Applying the criteria would allow differentiating LDCs according to the severity of their handicaps as well as addressing the specific concerns of graduating LDCs.

Trade-related measures for the LDCs: What has been done?

Trade promotes development, so it should be considered an instrument and not a goal. Yet, the special measures - developed in parallel with the strategy to support trade by LDCs - are not adequate or sufficient to make trade a strong instrument and means of development. As already recognized by the Doha Round, special and differential treatment (SDT) measures need to be more precise, effective and operational. But negotiations have been painfully slow, while the Monitoring Mechanism has yet to produce concrete results. And the space for SDTs for developing countries and LDCs seems to be closing fast, with the expectation that all WTO members will eventually abide by the same set of rules.

Chapter 5 indicates several challenges related to the use and effectiveness of the available set of SDTs for LDCs. However imperfect the current SDT provisions, they have a role in removing some of the obstacles LDCs face in increasing and diversifying their exports. But LDCs need to have a more active position and to get better acquainted with the measures developed for their benefit, including formulating requests for specific capacity building assistance programmes. Only through accessing and using these measures will LDCs be able to identify problems and formulate specific demands for change and improvement.

Part of the lack of effectiveness of the SDTs is that LDCs are not fully aware of them - and even when aware cannot productively use them due to communication and coordination failures at the country level. LDCs need to correct these problems and take more ownership of these provisions. Another part has to do with the way some of these measures have been designed (not necessarily tailored to the conditions in most LDCs). The “add-ons” they carry (such as stringent rule of origin and other requirements) and the lack of policy coherence at the global level mitigate the contribution that some measures could bring to LDCs.

Enlightened international cooperation is needed to address these shortcomings. The assessment of the Enhanced Integrated Framework and of the associated Diagnostic Trade Integration Studies, while underlining the potential of such a support to LDCs, return forcefully to the difficulty of promoting trade as an engine of sustainable development in LDCs and on the specific modalities supporting trade in these countries.

Trade marginalization of LDCs and its reversal: What impact of international support?

Since the start, special and differential treatment (SDT) has been an important vehicle supposed to help these countries develop faster including by increasing their participation in world trade, an objective re-iterated in the four UN LDC conferences and related programmes of action, particularly the Istanbul programme of action. The evolution of the LDC export share in world trade, and that of the diversification of their exports, reflects the evolution of their trade costs relative to the trade costs of other developing countries. These trade costs, increased by the structural factors inherent to the LDC category, are expected to be lowered by the special and differential treatment given to LDCs, particularly through market access, and can vary according to the individual policies of exporter LDCs.

On overall trade performance, the export share of LDCs in world exports, following a long period of decline, started to rise around 2000, first and significantly for oil exporters, then for other LDCs, mainly those exporting minerals. But for most LDCs, neither oil exporters nor mineral exporters, there has not been a clear reversal of decline, only stagnation. Moreover other than oil exporters, LDCs do not appear less diversified than other developing countries.

Does LDC membership matter for trade performance? On average over 1995-2014, LDCs export around 30 percent less than other developing countries. Controlling for trade costs, the impact of membership in the LDC category has been stable and significantly negative over the period, notably towards the United States and the European Union even after the Everything But Arms (EBA) and African Growth and Opportunity Act (AGOA) agreements. Nor has there been a noticeable catching up of exports to the United States or especially to China. Still controlling for trade costs, LDC exports to China at the end of the period were no longer significantly different from those of other developing countries.

The European Union and United States, the two most important markets for LDC exports among grantors of nonreciprocal preferences, have been progressively engaging in a multitude of regional trade agreements with developing countries, many since the early 1990s. Already for 2012 estimates covering all regional trade agreements by the European Union and United States show a strong erosion of preferences. For the European Union the average (trade-weighted) adjusted preferences for LDCs are cut in half and stand at 3 percent. For the United States the adjusted preferential margin was a negative (-1.3 percent), meaning that the LDCs were discriminated against for products they sell in the US market.

This absence of special and differential treatment is compounded by two other measures in the policies of grantor countries. First, with the exception of a simplification of technical requirements in the apparel sector (in 2001 for AGOA beneficiaries and in 2011 for EBA beneficiaries), developed countries made no effort to simplify their rules of origin requirements for LDCs until the December 2015 decision that a product originating in an LDC will qualify for preferential treatment so long as nonoriginating materials do not exceed 75 percent of the final value of the product. Second, there is little specific information on how nontariff measures affect LDC exports, beyond casestudy evidence that sanitary and phytosanitary regulations in the United States and European Union are inhibiting developing country exports. But since the 2008 crisis, over 6,000 measures collected for the Global Trade Alert database show that close to 500 distorted LDC exports are estimated to have reduced LDC exports by $265 billion over 2009–13, equivalent to 31 percent of the total value of LDC exports.

Other important factors undermine progress in LDC trade performance, particularly deficient hard and soft infrastructure and related LDC policies. These internal factors may be influenced by the structural features of LDCs (income, human capital and economic vulnerability), but they can also be improved with the help of the international community. The Aid for Trade initiative launched in 2005 and the Trade Facilitation Agreement of 2013 – while not exclusively directed towards LDCs – are both largely targeted towards improving their supply capacities and trade performance. Three main factors have been identified.

First, the lack of appropriate domestic institutions may well be a binding constraint to exporting in LDCs with a comparative advantage in agricultural products. Second, poor performance in logistics markets has been systematically found to be the main driver of cross-country differences in trade costs, justifying the allocation of AFT funding on hard and soft infrastructure. For example, it is estimated that an improvement in customs management by individual LDC group members to the group frontier could reduce trade costs for imports needed for exports by 2 percent for LDCs and 3 percent for landlocked LDCs. Third, spending on trade performance optimization has positive effects on exports at the intensive margin (expanded volumes) and at the extensive margin (new products and new partners). Greater emphasis on TPO (Trade promotion organizations) activities should help improve the trade performance of LDCs

Graduation from the category of least developed countries: Rationale, achievement and prospects

The LDC category was created to help countries develop more quickly, so that they can leave the category. But the graduation of LDCs has been successively forgotten, feared and desired. During the first 20 years of the category, from 1971 to 1991, no graduation rules were established. During the following 20 years, countries mainly saw graduating as a risk to be postponed. In 2011 at the 4th UN Conference on LDCs in Istanbul, making half of the LDCs meeting graduation criteria became a goal by 2020, an ambitious, though unreachable target designed in the Istanbul Plan of Action.

The LDCs' graduation has been slow and recent. This stems from two main factors, besides the countries' own resistance. One has been LDCs' long-lasting growth lag, which has reversed somewhat since the mid-1990s. The other major one has been the strong asymmetry between inclusion and graduation criteria. To avoid any risk of reversibility, precautionary conditions had been set up before the Committee on Development Policy recommended an LDC for graduation. Criteria had to be met not at one but at two successive triennial reviews, with margins set up between the inclusion and graduation thresholds of the criteria indicators. (Two criteria had to cease to be met, while three complementary criteria were needed for inclusion). Moreover, an additional three-year period was set up after graduation has been decided but before it became effective.

As a result, in 2018, 31 of the 47 LDCs were no longer meeting the inclusion criteria without being graduated (that is, only 16 of the 47 LDCs still met the inclusion criteria). While the Plan of Action's goal was that half the 48 LDCs would meet the graduation criteria in 2020, there will be only fewer than a fifth. They will include two countries already graduated (Equatorial Guinea and Samoa), five countries set to graduate (Vanuatu in 2020, Angola in 2021, Bhutan in 2023, Solomon Islands and Sao Tome and Principe in 2024). For two countries (Tuvalu and Kiribati) the recommendation of the committee has not been endorsed by the ECOSOC, which has deferred its decision to 2021. Most countries graduated have been recommended for graduation or are likely to be, from 2007 to 2020, are small island developing states (9 of 14), all still vulnerable.

This asymmetry between inclusion and graduation criteria has weakened the category's consistency and calls for changes in the criteria for graduation and inclusion. Several proposals have been presented, the simplest relying on identifying LDCs from two instead of three criteria, with the economic vulnerability and human assets criteria merged into a structural handicaps index. It would take each into account, and could be designed so that it would still reflect the interaction between the two kinds of structural handicaps. This new index could be used for inclusion and graduation or only for graduation.

The various studies conducted before or after graduation and reviewed in chapter 7 do not show a significant negative effect of graduation for the few graduated countries. They do not show them being at risk of falling back into the category. The pace of development that led them to graduation does not appear to slow down, despite significant remaining vulnerability.

Is this a paradox? All the chapters try to show the positive effect that LDC membership has or could have on the development of countries through the special measures they receive. One might then expect that exiting the category would have a symmetrically negative impact. But the effect of the special support measures is highest when the country is "least" developed, or far from graduation and most needing those measures. And smooth transition strategies have eased the change in status by means such as the continuation of some special measures or access to new sources of finance. The international context, supporting the economic growth of several LDCs close to the income threshold, probably has also made the transition easier. This can of course change due to exogenous shocks, particularly commodity prices. And graduation, by alleviating the LDC structural handicaps (in the case of the few graduated countries, poverty reduction and human capital improvement), also involves some structural transformation of the economy likely to sustain its development.

The limited number of graduations in the period covered by the Istanbul Plan of Action should be an incentive to implement and reinforce the support measures progressively adopted and agreed on in Istanbul. These measures are not just for potentially graduating countries, but for all LDCs. The major issue is the effect of support measures for the countries included on the LDC list, even more than the effect of graduating from the list.

Least developed countries and global economic governance

LDCs have benefited from trade and finance initiatives by the international community. The chapters show that the actual implementation and permanence of these Measures - and to some extent their effectiveness - remained below expectations. This contradicts resolutions and commitments agreed on by the development partners of LDCs during global conferences and the four UN conferences on LDCs. Part of the explanation may be the lack of representation of LDCs in global governance. No LDCs participate directly in the G7 or G20. The two most important global organizations for LDCs - the IMF and the World Bank - are precisely those where power is linked to contributions. Indeed, the LDC situation appears to be more positive at the WTO, but systematic attempts to reach consensus there favour countries able to be represented on a continuous basis, while the treatment of disputes favours those in a position to implement credible retaliatory measures. At the Conference of Parties 21 the issues of financing, essential for LDCs, have been largely put aside, to avoid compromising adoption of the Paris Agreement by consensus.

The lack of LDC representation in major international institutions helps explain the mistrust that LDC leaders feel towards them. It is not fair to advocate strengthening democracy in the poorest countries while refusing them the opportunity to participate in decisions that concern them at a global level. Increasing the involvement of LDCs in the international architecture is, however, a difficult task that does not currently appear to be a priority for the international community. Can LDCs hope to participate in meetings at G20 summits? Will their participation in the Bretton Woods institutions be decoupled from their quotas and wealth? The extension of global governance to areas such as the environment and social policy should be an opportunity to think about the participation of LDCs.

The legitimacy of their participation and that of the international support measures depends on the rationale of the category, and of the identification criteria on which it relies. While several support measures can be designed according to the criteria, making the graduation smoother, participation in global governance still needs to refer to the category. This can be managed whatever the speed reducing the number of LDCs. Graduations from the list are likely to enhance the consistency of the category, and making a better place for LDCs in global governance will also accelerate graduation.

Revisiting the category and its criteria to enhance its consistency and effectiveness

The Least Developed Countries remain poor countries facing the most severe structural handicaps to sustainable development, so a better design of the category and its criteria can help reinforce their rationale and legitimacy. Barely more than a third of LDCs still meet the criteria for inclusion in the category and fewer than a fifth meet the preliminary criteria for graduation. So around half the LDCs meet neither the inclusion nor the graduation criteria.

The category obviously needs to be refreshed to become both more consistent and more effective. The challenge is still supporting genuine LDCs in their effort to move out of the trap. The 5th UN Conference on LDCs to be held in 2021, half a century after the creation of the category, is a good opportunity to implement such a reform. As the category is narrowed and made more consistent, its criteria can be used more broadly to design policy measures such as development assistance allowing a progressive treatment, as already suggested by *Caught in a trap*.

FERDI

Created in 2003 , the **Fondation pour les études et recherches sur le développement international** aims to promote a fuller understanding of international economic development and the factors that influence it.

Contact
www.ferdi.fr
contact@ferdi.fr
+33 (0)4 73 17 75 30

n° ISSN : 2275-5055

policy brief
197
December 2019
note brève