



From inclusion to graduation
Why the least developed countries
were « caught in a trap »
and should move « out of the trap »

by

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Smooth Transition of LDCs towards Graduation »**

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What to be an LDC means

- LDCs are designed as low-income countries suffering the most from structural handicaps to growth
- As such they are the most likely to stay poor or « caught in a trap »: for structural reasons (independent from their present will), they are the « least likely to develop » countries and for that deserve special treatment
- Understanding the nature and interaction of these structural obstacles is crucial for the rationale of the category and the identification criteria, for designing the support measures to the LDCs and a smooth transition for graduating countries



(How the list of LDCs is designed)

- Since the beginning of the category in 1971, the CDP has had to design and refine the criteria, and to make recommendations for inclusion of new countries
- Since 1991, at triennial reviews of the list, it makes recommendations both for inclusion into and for graduation from the list
- CDP recommendations are examined by ECOSOC which formulates resolution, then the GA takes the decision



Why the LDC category should normally be « self cancelling »

- LDC category created in 1971 to mobilize support to those developing countries facing the most severe obstacles to grow
- Hence a category intended to allow the LDCs to overcome these obstacles, to move « out of the trap »
- A natural consequence should then be a diminishing number of countries locked into a trap: the success of the category would be a shrinking extent of the category
- Not exactly what has happened



The number of LDCs has been growing

- From 25 in 1971 to 50 in 2003-06, now 49
- Among newly included states were new states (14/ 26), but many new other inclusions and during nearly 40 years only 2 graduations
- Possible result of several factors:
 - Some inherent to the category, the existence of a «*trap* »
 - Some linked to the design of the identification *rules* and their change
 - Some linked to the international environment and the *lack of effectiveness* in the the special support measures



Why the LDCs are at risk to be caught in a trap: the economic meaning of the criteria

- Three *complementary* criteria for inclusion
 - GNIpc (fixed low income threshold of the WB)
 - Two composite indicators of structural handicap
 - HAI (Human Assets Index), reflecting health and education levels
 - EVI (Economic Vulnerability Index), reflecting the risk of exogenous shocks and the exposure to these shocks
- This complementarity means that the trap is due to the *interaction* of low human capital and high structural vulnerability
- Consistent with empirical evidence



The growth lag of LDCs explained the combined effect of structural handicaps

- From 1970 to 2000, stagnation of income pc in most LDCs (improvement after 2000, due to exogenous factors)
- Widening gap between LDCs and other developing countries: polarization, *twin peaks* (graphs)
- LDCs as an exception to absolute convergence
- But *convergence conditional on structural handicaps* (HAI and EVI), evidencing the relevance of criteria
- $G(y) = f(y_0, \text{HAI}, \text{EVI}, \text{LDC})$ (LDC ns)
- $G(y) = f[\ln y_0, \ln(100-\text{HAI}), \ln \text{EVI}]$
the two structural handicaps not perfectly substitutable

The(-) elasticity of growth to each handicap rises with the value of the other: *mutual reinforcement of handicaps*



Has inclusion become easier?

- Initially 3 absolute criteria: GDPpc, literacy, share of manufacturing
- Now: GNIpc, HAI and EVI (APQLI and EDI in 1991)
- Making LDCs identified as LICs facing *relatively high structural handicaps* to growth (with regard to thresholds corresponding to the quartile of a reference set of LDCs and LICs) : has made easier the inclusion at the beginning of 90s
- Prospects? Indeed among low income countries there are always some facing relatively high handicaps
- But, to be LDCs, they should face severely *the two* handicaps...and less and less not LDC countries are still low income
- Thus low probability of new inclusions



Why so few graduations? The impact of the rules

- For inclusion, needed to meet the three criteria (complementary)
- For graduation, four precautions to insure the sustainability of progress and avoid disruption effects:
 - a country should fail to *meet two*, rather than only one, of the three criteria (*asymmetry*)
 - thresholds for graduation differ by a *margin* from those for inclusion;
 - to be recommended for graduation a country has to be found eligible at *two successive triennial reviews...*
 - and graduation takes place only *three years after* the decision by the GA

Discordance resulting from criteria asymmetry: insuring equality of treatment over time

- Due to the asymmetry of graduation and inclusion rules in 2009:
 - a) 18 LDCs, without being eligible to graduation, would no longer be eligible for inclusion (11 in 2006)
 - b) 5 other LICs, not considered for inclusion, would not be eligible to graduation, had they been on the list (8 in 2006)
 - c) Thus 23 »discordant » countries are meeting neither inclusion nor graduation criteria (19 in 2006)
- Normal group, only if reasonable size:
 - a) reflects an improvement among the LDC group and a potential for graduation
 - b) raises a problem of equity, but a decreasing one



Addition and exceptions to the rules

The graduation in practice

- Addition: eligibility when income pc > twice the ordinary graduation threshold (1 criterion met = more symmetry)
- Exceptional postponement by 3 additional years due to tsunami decided for Maldives in 2005, and recently for Samoa: 2 countries for which graduation had been decided, but was not yet effective
- Graduation not an easy process: countries eligible to graduation generally reluctant to be graduated, resulting lags in the decision process after the recommendation by CDP, either before a consensus at ECOSOC, or between ECOSOC and GA decision (Eq Guinea)



The reasons behind the concern about graduation:

The vulnerability issue

- Paradox of resistance to graduation while countries eligible to inclusion refuse to be included
- Common feature of all recently graduated, graduating or simply found eligible without being recommended, as for 2 countries at the last triennial review by CDP: SIDS
- Concern of SIDS likely to be graduated linked to several factors: fear to lose advantages of the category, high level of economic vulnerability, and in some cases long term vulnerability to climate change



How the vulnerability issue has been addressed

- Concern not to undermine the rationale and credibility of the category
- Huge move of CDP during the last 10 years to take vulnerability into account, through the design and refinement of the EVI, and the consideration of the vulnerability profiles prepared by UNCTAD
- Recommendations to graduate : applied to countries with a relatively high level of human capital and having been able to reach a medium level of GNIpc : countries clearly out of the trap of lowincome
- Still consistent with a partial complementarity of obstacles: referring to a structural handicap index combining HAI and EVI in a proper manner did not change the eligibility to graduation
- But two remaining issues: transition and climate change



Making transition smoother by using identification criteria as aid allocation criteria (1)

- Making transition smoother difficult when support measures are of binary nature
- Easier when more continuous treatment applicable, as it is the case for ODA
- Rationale to use LDC identification criteria as aid allocation criteria (besides the usual criteria giving overwhelming weight to policy and governance, such as those used by the MDBs with the « PBA »)



Making transition smoother by using identification criteria as aid allocation criteria (2)

- Would meet the principles of a fair allocation
 - equity (compensating structural handicaps)
 - effectiveness (aid as a way to dampen the negative impact of shocks on growth)
 - transparency (avoiding multiple exceptions to the rule)
- Would make the transition smoother for the small graduating countries, the vulnerability of which would remain taken into account



Addressing separately vulnerability to climate change

- Vulnerability to climate change is a major issue, although not specific to LDCs, and a rather long term one
- Economic vulnerability to natural shocks already taken into account in several components of EVI
- The long term vulnerability to climate change (for LDCs and other developing countries) needs an appropriate index difficult to set up and not yet available
- It would be a fair criterion of allocation of concessional resources for adaptation to climate change
- Special support for adaptation, when needed, should be a welcome component of a smooth transition strategy

Thanks