



**Regional integration for facing vulnerability  
and facilitating graduation**

***L'intégration régionale pour réduire la vulnérabilité et  
faciliter la graduation***

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**(I)**

**Graduation prospects in Laos and the vulnerability issue**



## **graduation as a result of structural transformation**

- LDCs are designed as poor countries facing structural handicaps to development
- Graduation involves a capacity to overcome these structural handicaps, assessed through specific criteria
- This needs a structural transformation, likely to lead to a sustainable development
- With IPoA, graduation has become an agreed goal, instead of being seen mainly as a risk
- Meeting graduation criteria is expected to reflect a structural change and it so as far as the indicators reflect structural handicaps to development



**The graduation criteria in brief:  
a test of overcoming structural handicaps to growth**

- *Traditional criteria:* 2 out of the 3 inclusion criteria (GNIpc, HAI, EVI) to no longer be met, GNI inclusion criterion is the LIC threshold, HAI and EVI ones were relative to a reference group (beyond a margin: 20% for GNI, 10% for HAI and EVI)
- *Alternative 2006 criterion:* GNIpc above twice the ordinary graduation threshold (240% of the inclusion threshold)
- Low HAI, High EVI reflect *structural handicaps*, increasing HAI, and/or a decreasing EVI evidence favourable *structural change* likely to lead to sustained growth
- a GNIpc more than twice the LI threshold reflects a capacity to overcome the structural handicaps

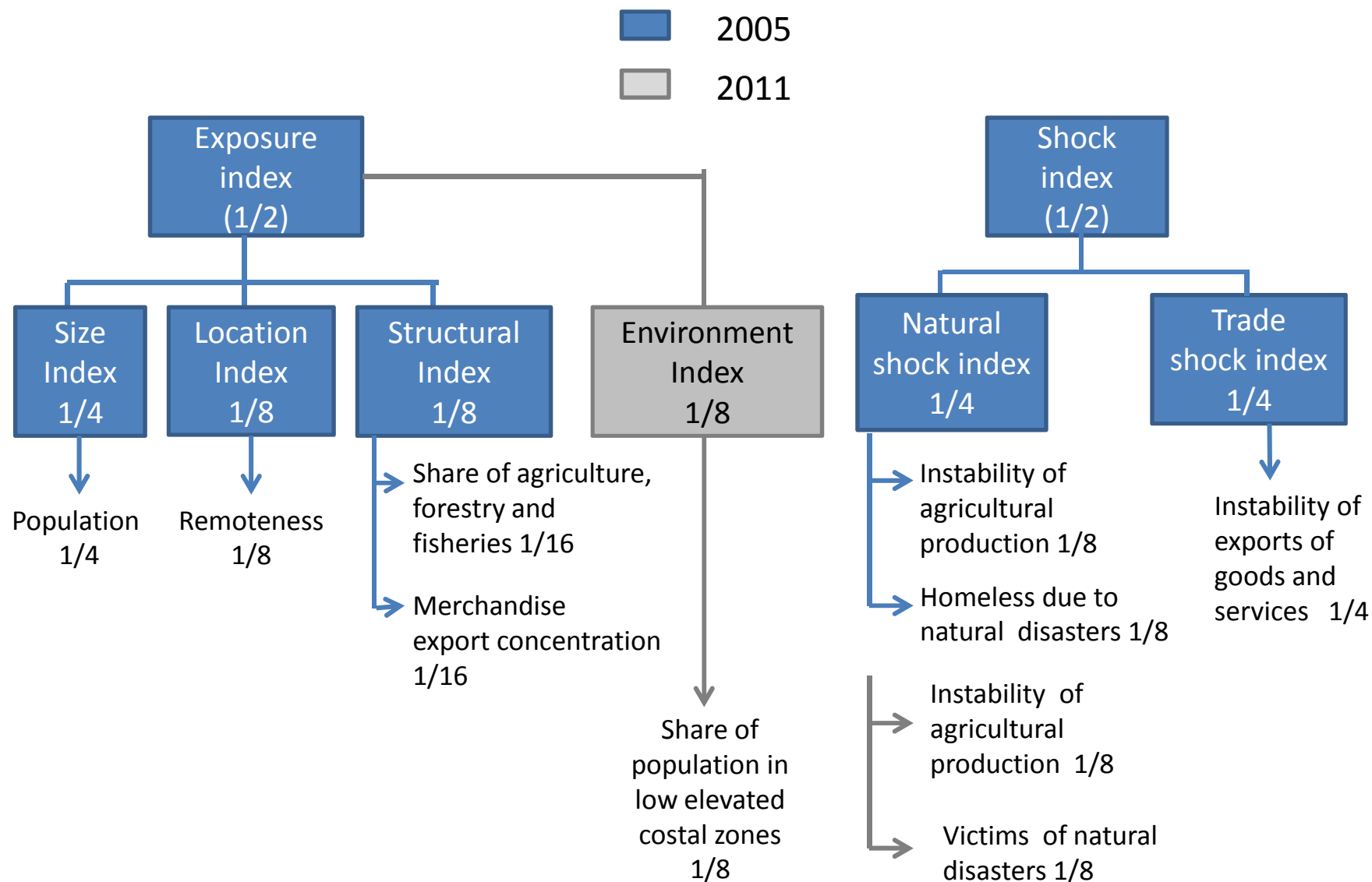


## Sources of graduation

- *Traditional double criteria:*
  - the *couple GNIpc + HAI* has been the main source of graduation during the last 10 years (Cape Verde, Maldives, Samoa)
  - may remain effective in some cases (Solomon Islands, SaoTPR)
  - little prospect of graduation with regard to the *EVI criterion*: only likely, combined with HAI, for Nepal (and Bangladesh)
- *Income-only criterion* (as first implemented for Eq. Gu.):
  - already reached by Angola + several Asia-Pacific LDCs (Tuvalu, Vanuatu, Kiribati, Timor Leste) , nearly reached by Bhutan
  - likely to be the *main source of eligibility in this decade*,
  - often associated with meeting the HAI criterion (except Angola)
- **NB Laos** does not yet reach any graduation criterion: close to the GNIpc one, less so to the HAI one, even less to the EVI one



## Economic Vulnerability Index (EVI)





Level of EVI and components indices, 2012 review of the list of LDCs  
**Laos compared to the average of LDCs (...)**

• <b>EVI</b>	<b>39.2 (43.6)</b>
• <b><i>Exposure</i></b>	<b>42.6 (42.1)</b>
• Smallness of population	42.0 (43.4)
• Remoteness	62.0 (60.9)
• Export concentration	26.2 (42.8)
• Agricultural value added (share)	49.0 (48.2)
• LECZ	0 (18.6)
• <b><i>Shocks</i></b>	<b>35.7 (47.0)</b>
• Instability of exports (Gds & serv.)	18.9 (47.4)
• Instability of agricultural production	20.9 (24.3)
• Pop victims of natural disasters	85.3 (68.8)
• (homeless)	90.7 (54.3)



## **Vulnerability to climate change not fully taken into account**

- Vulnerability to climate change is indeed an obstacle to sustained development : should it be taken into account in the criteria for the identification of LDCs (inclusion and graduation) or treated separately through a specific index, such as the Ferdi PVCCI?
- Longer time horizon and change not reflecting a structural transformation
- Choice made by the CDP to include an « environment component », but the simple inclusion of the LECZ index results in a biased change of EVI: minoring vulnerability in landlocked and arid countries (Sahel countries), as well as in a small mountainous island (Vanuatu), and in countries threatened by other flooding than the sea level rise, such as GLOF and other flooding in Bhutan and Nepal (minus 7 ranks for Laos)
- A bias that could be easily corrected within the present EVI structure
- In the Ferdi PVCCI, high level of the Laos indices of intensification of recurrent shocks in rainfall and temperature (but low level of the indices of progressive shocks)





## **Why graduation prospects lag behind the IPoA goal of halving the number of LDCs meeting the graduation criteria by 2020, in spite of (structural) progress**

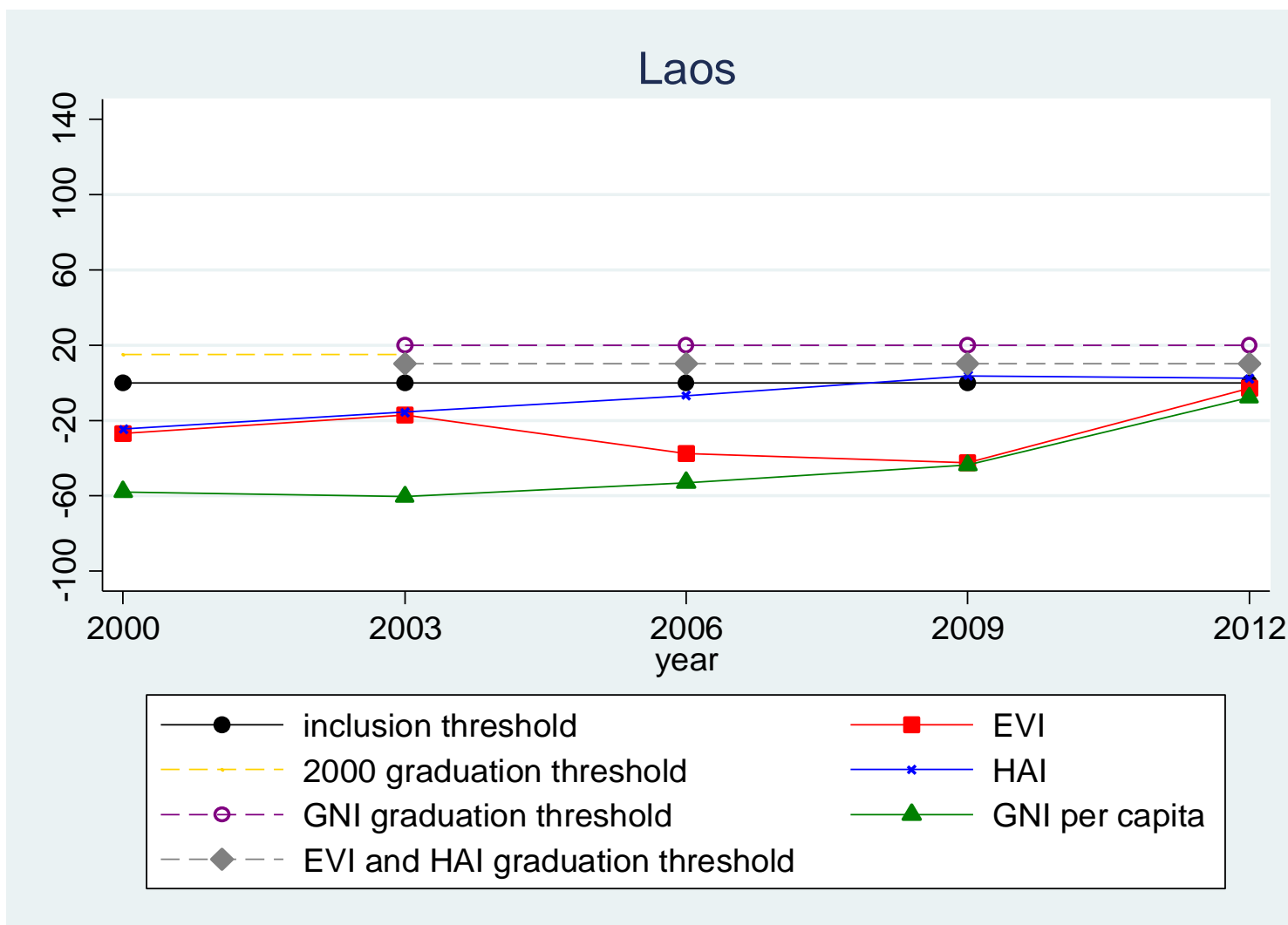
- Asymmetry of criteria: at the 2012 review, 26 out of 49 LDCs did no longer meet the 3 complementary inclusion criteria, and all of the 13 Asia-Pacific LDCs (except Afghanistan)
- Length of the graduation process (double triennial eligibility, then 3 year delay after GA endorsement = at least 6 years after 1st eligibility)
- Relative character of the HAI and EVI criteria (until 2012): general improvement did not change the ranks in the reference group
- Present prospects according present criteria: no more than 10 countries likely to have met the criteria by 2021, of which 2 already graduated, all but Angola in Asia-Pacific



## Improving the position EVI (or HAI) with respect to the thresholds does not mean structural transformation

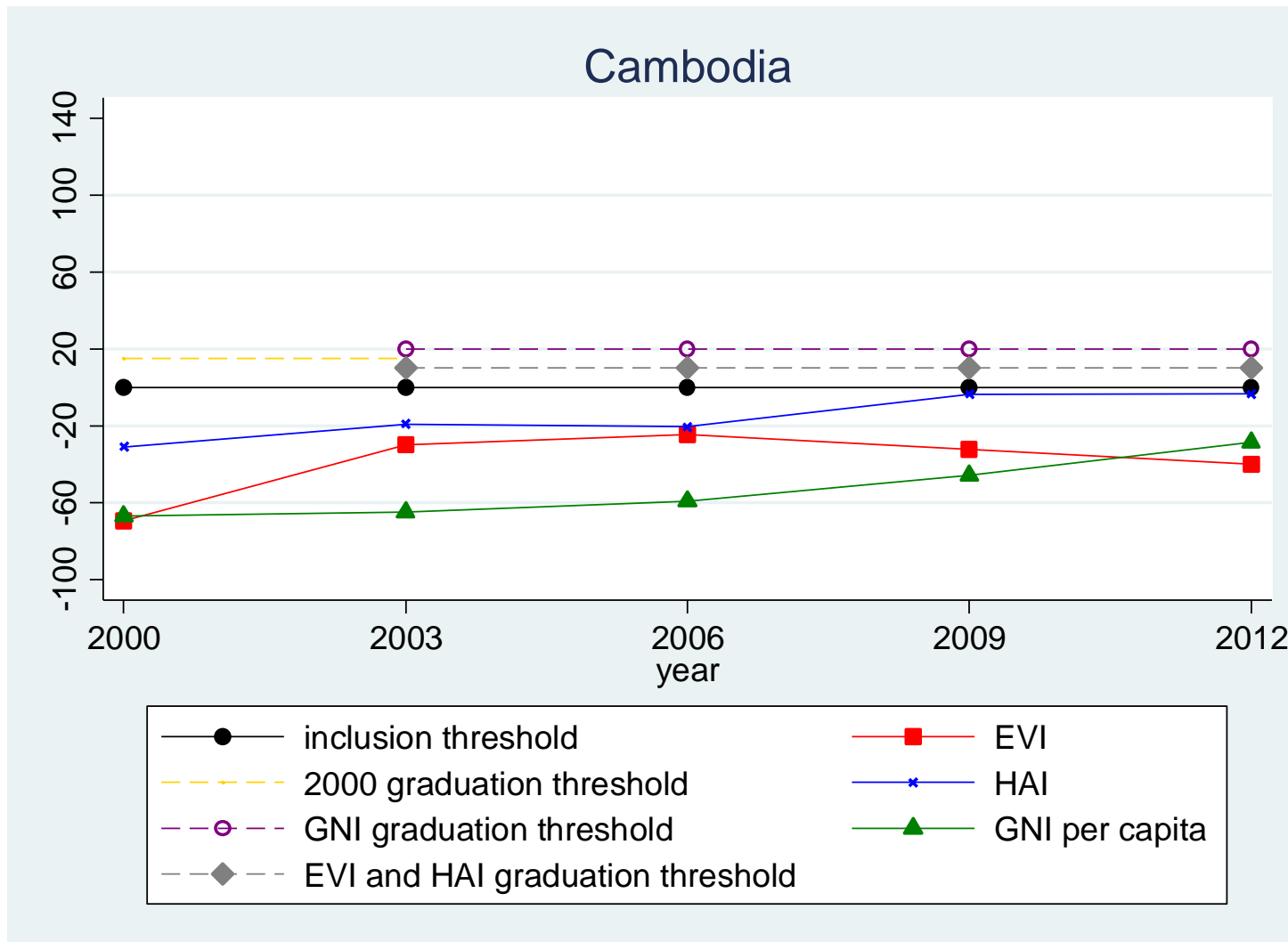
- The thresholds may have moved with the changes in the reference groups
- The composition and/or calculation of the indices may have changed: impact of the change in EVI between 2009 and 2006 with the addition of an « environment component » (LECZ) with a weight taken from that of the smallness of population size
- Increase of EVI in Bangladesh, Cambodia, decrease in PDR Lao, Bhutan, Nepal (graphs), without really reflecting a negative/positive structural change
- See graphs

Relative evolution of Laos' position with respect to the graduation and inclusion thresholds over the five last triennial reviews



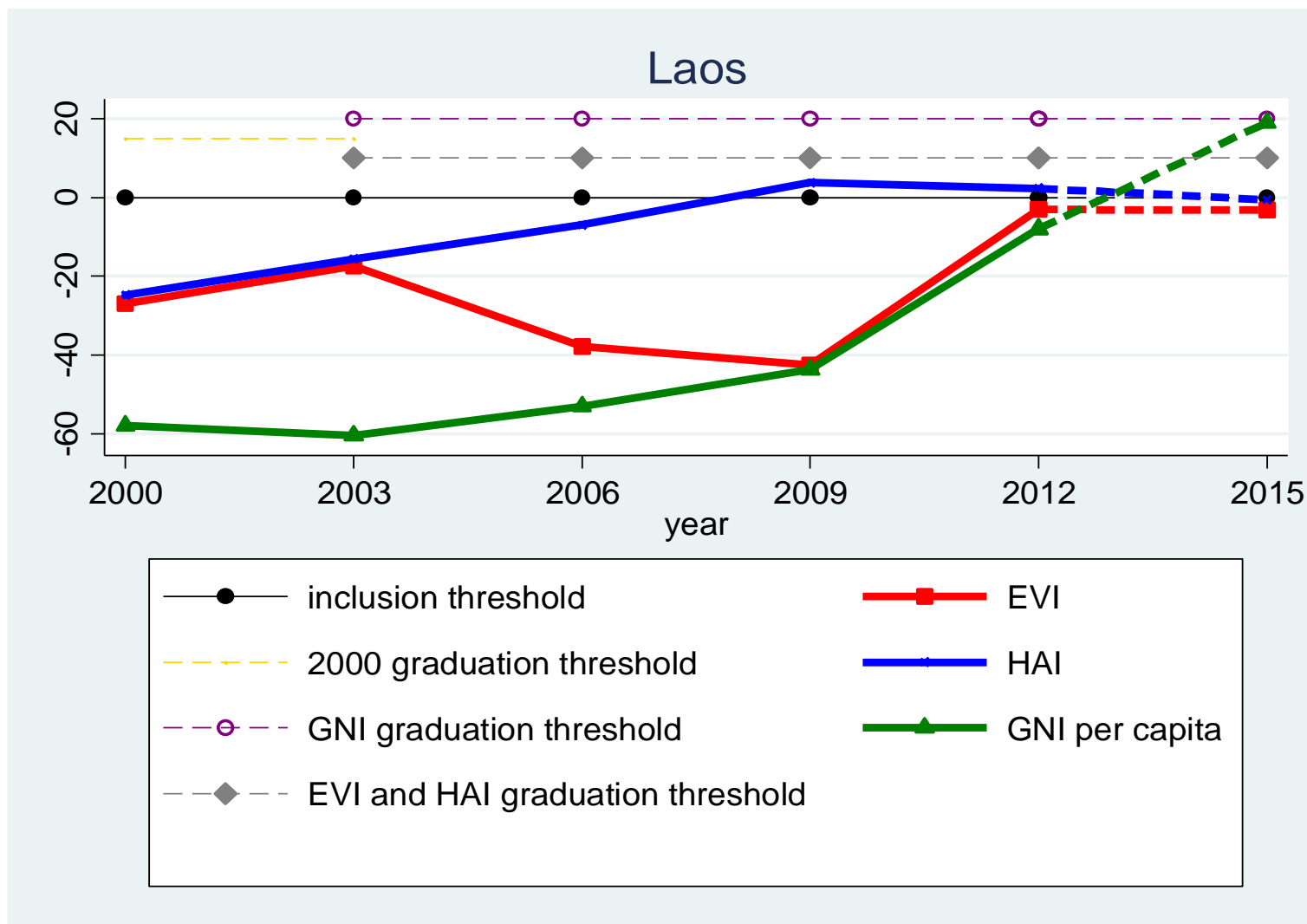


### Relative evolution of Cambodia's position with respect to the graduation and inclusion thresholds over the five last triennial reviews





### Relative evolution of Lao PDR's position with respect to the graduation and inclusion thresholds over the six last triennial reviews





**Lessons from retrospective series from 2000 to 2011:  
decrease in EVI calculated from an unchanged definition (the 2012 one)**

- *Stronger decreases, observed*
  - from an initially high level (convergence?): Lao PDR (-18), Cambodia (-14), Yemen (-12) Vanuatu (-10), Tuvalu (-10), Samoa (-7)
- *Moderate decreases, observed*
  - either from a high level: Solomon Islands (-3), Kiribati (-3),
  - or from a low level: Bangladesh (-3)
- *No decrease or increase, observed*
  - either from a moderate level: Bhutan (- 0.5)
  - or from a rather low level: Afghanistan (+ 1.5), Myanmar (+2.5)
- Lack of retrospective data: Timor Leste (high present level)
- Also done from the 2006 definition, with close results
- But the 2012 definition with the new component LECZ, moving slowly, and reducing the weight of (increasing) population slows down the decline of EVI...and the apparent impact of structural change



## Back to the category rationale for the graduation: addressing structural handicaps

- Better performance of LDCs in HAI than in EVI improvement, with a determinant impact of HAI on graduation: lag in reduction of structural vulnerability
- Structural transformation involves both human assets *and* vulnerability: while human capabilities are a crucial and structural factor of resilience, structural vulnerability remains a challenge
- Present treatment too dichotomic: referring to a *structural handicap index*, averaging EVI and (low) HAI, would give a *better criterion for graduation*
- It would make (or have made) easier to meet the graduation criteria for countries wishing to graduate, more difficult for those wishing to avoid graduation...



**(II)**

**Regional integration for facilitating graduation  
through lower vulnerability and higher growth**





## Regional integration: Laos and Africa briefly compared

- Many forms of RI, in Africa as elsewhere, from the traditional trade integration, with various degrees (FTA, Custom union, common market...) to the deep integration ( monetary union, policy coordination, integrated infrastructure,...)
- Reference to economic and monetary unions of the franc zone (UEMOA and CEMAC), compared to ASEAN and Grand Mekong membership of Laos
- UEMOA and CEMAC « more integrated » through currency, customs, search of policy convergence and institutions (with a dose of supranationality)
- Laos « more integrated » through infrastructure... and trade flows
- In both cases association of LDCs (benefitting from special treatments) and non-LDCs:



## Difficult assessment of the impact of RI reinforcement Some lessons of previous works

- RI is *multidimensional* and not only trade integration:
  - monetary and financial integration essential for trade integration, (in FZ monetary unions prior to custom unions)
  - other aspects of deep integration essential as well (infrastructure, business rules, sectoral policies..)
- RI as decided differs from RI as *implemented*: large gaps, mainly in trade and fiscal matters, due to lack of political will and bureaucratic inertia, enlarged by traffic insecurity
- RI may improve policy and governance, and is likely to lower the occurrence and the damage of conflicts, in particular in Africa
- Effects missed in the traditional static analysis of the effects of CUs



## **Need of new methods for assessing the growth impact of RI: two methods used**

- Additive method: assessing separately the impact of the various integration measures, through their effect on intermediary variables influencing growth (trade, financial deepening, investment, rule of law,...) with the risk of missing the interaction between these measures, and missing some other relevant variables
- Global method: simulating the rate of growth of each country as if fully integrated in a given set of countries



## Taking into account vulnerability reduction in assessing the growth impact of RI

- The method applied: a global evaluation of the growth impact of a full integration, unlike an examination of the impact of specific measures taken to reinforce regional integration: full integration would mean that all the member countries are as if they were only one country (one market, one policy)
- Each country would then fully benefit from the union size, through a larger population size and a *lower vulnerability to external shocks* (scale economies and risk sharing)



## Implementing the method

- Growth regression estimated with GMM on a large sample of developing countries and over 7 five-year periods (1975-2010)
- Including only factors supposed to be roughly independent of policies (and integration)
- Among which are the population size (in log) and the structural vulnerability (proxied by export instability), which can be modified at the country level according to the perimeter of the union
- Other (usual) factors include: initial income pc, population growth, child mortality, rainfall, terms of trade, oil rent, IDE to GDP ratio, all significant

## Two size-related factors of economic growth...

- Two factors related to size appear to be robust determinants of growth in many growth regressions, for well established reasons
- Population size (+), due to scale economies in various fields, economic and administrative as well, possibilities of efficient diversification for the domestic market, then the export market
- Export instability (-), due to its effects on the rate and, even more, on the productivity of investment, and on fiscal stance (risk and asymmetry effects)
- These two factors are deeply modified by a full integration, which enlarges the domestic market and the perimeter of risk sharing (labor and capital mobility, fiscal transfers,...)

## Calculation of the gains

- For each country member of the union, calculation of the increase in the population size (in log) and the decrease in export instability corresponding to the difference between the union level and the country level (export instability of the union is that of the exports out of the union)
- To estimate the potential gain, these changes are multiplied by the coefficients of the previous regression
- Estimated coefficients: 0.4 for the log of Pop and -0.074 for the export instability index (close to coefficients found in the literature) (coefficients slightly different when the variables aid and conflict are in the regression: +0.56 and -0.05 respectively)



## Results and caveats

- Significant average gain obtained for FZ unions weighted average annual growth rates measured on 7 five-year periods from 1975 to 2010 : between 1.5 and 2%
- Mainly due to broader population basis, then to greater stability
- Limited sensitivity to the estimation of the coefficients of the two variables (population coefficient higher, not lower when China and India are out of the sample)
- But very rough estimate, supposing that all the measures are taken and applied to implement a full integration
- Possible replication to Laos within Asean, similar impact expected, although higher observed growth





## Complementarity of the methods

- The results of the two methods (scale change and intermediate variables ) are not a priori additive
- The first global method has the advantage of simplicity, drawing a perspective under the condition that all the needed integration measures are taken and implemented
- The second may help to identify the channels by which more integration is likely to speed up growth, in a progressive way
- Nevertheless the full integration as captured by the first method corresponds to what actually occurs in larger single countries, where the integration is not perfect. In some specific areas the process of integration between independent countries may go further or deeper than the integration within a single country. To this extent, there may be some additivity of the gains estimated by the two methods.



## **Conclusion: regional integration for smooth transition**

- RI may accelerate graduation by accelerating growth
- One reason for that is the lowering of economic vulnerability resulting from RI
- This lower vulnerability is also crucial for the transition after the graduation out of the LDC category: contributes to a « smooth transition »
- The open issue: what are the more relevant out of all possible integration measures for a country such as Laos? A political, as well as economic, choice, indeed.

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