UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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THE LEAST DEVELOPED COUNTRIES REPORT 2016

The path to graduation and beyond: Making the most of the process



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What are the least developed countries?

Forty-eight countries are currently designated by the United Nations as "least developed countries" (LDCs). These are: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, the Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, the Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia.

The list of LDCs is reviewed every three years by the Committee for Development Policy (CDP), a group of independent experts reporting to the United Nations Economic and Social Council (ECOSOC). The CDP, in its report to ECOSOC, may recommend countries for addition to, or graduation from, the list of LDCs. The following three criteria were used by the CDP in the latest review of the list, in March 2015:

(a) Per-capita income, based on a three-year average estimate of the gross national income (GNI) per capita, with a threshold of $1,035 for possible cases of addition to the list, and a threshold of $1,242 for cases of graduation from LDC status;

(b) Human assets, involving a composite index (the Human Assets Index) based on indicators of (i) nutrition (percentage of undernourished population); (ii) health (child mortality ratio); (iii) school enrolment (gross secondary school enrolment ratio); and (iv) literacy (adult literacy ratio);

(c) Economic vulnerability, involving a composite index (the Economic Vulnerability Index) based on indicators of (i) natural shocks (index of instability of agricultural production; share of victims of natural disasters); (ii) trade-related shocks (index of instability of exports of goods and services); (iii) physical exposure to shocks (share of population living in low-lying areas); (iv) economic exposure to shocks (share of agriculture, forestry and fisheries in GDP; index of merchandise export concentration); (v) smallness (population in logarithm); and (vi) remoteness (index of remoteness).

For all three criteria, different thresholds are used for identifying cases of addition to the list of LDCs, and cases of graduation from LDC status. A country will qualify to be added to the list if it meets the admission thresholds on all three criteria and does not have a population greater than 75 million. Qualification for addition to the list will effectively lead to LDC status only if the government of the relevant country accepts this status. A country will normally qualify for graduation from LDC status if it has met graduation thresholds under at least two of the three criteria in at least two consecutive triennial reviews of the list. However, if the three-year average per-capita GNI of an LDC has risen to a level at least double the graduation threshold, and if this performance is considered durable, the country will be deemed eligible for graduation regardless of its score under the other two criteria. This rule is commonly referred to as the "income-only" graduation rule.

Four countries have so far graduated from LDC status: Botswana in December 1994, Cabo Verde in December 2007, Maldives in January 2011 and Samoa in January 2014.

In March 2009, the CDP recommended the graduation of Equatorial Guinea. This recommendation was endorsed by ECOSOC in July 2009, then by the General Assembly in December 2013. The General Assembly established as June 2017 the date of Equatorial Guinea's graduation from LDC status.

In December 2015, the General Assembly endorsed the CDP's 2012 recommendation to graduate Vanuatu. The Assembly took into consideration the serious disruption that was caused to Vanuatu by Cyclone Pam in March 2015, and decided, on an exceptional basis, to delay to December 2020 the country's graduation from LDC status.

The CDP's 2015 recommendation to graduate Angola was endorsed by the General Assembly through a resolution, in February 2016, that set February 2021 as the date of Angola's graduation from LDC status. This decision was an exceptional measure to take into account the high vulnerability of the Angolan economy to commodity prices fluctuations.

In a June 2015 resolution, ECOSOC recalled the CDP's 2012 recommendation to graduate Tuvalu from LDC status, and deferred to 2018 the Council's consideration of this potential graduation case.

After a recommendation to graduate a country has been endorsed by ECOSOC and the General Assembly, the graduating country benefits from a grace period (normally three years) before graduation effectively takes place. This period, during which the country remains an LDC, is designed to enable the graduating State and its development and trading partners to agree on a "smooth-transition" strategy, so that the planned loss of LDC status does not disrupt the socioeconomic progress of the country. A smooth-transition measure generally implies extending to the graduated country, for a number of years after graduation, a concession the country had been entitled to by virtue of LDC status.

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EXPLANATORY NOTES

The term "dollars" ($) refers to United States dollars unless otherwise stated. The term "billion" signifies 1,000 million.

Annual rates of growth and changes refer to compound rates. Exports are valued f.o.b. (free on board) and imports c.i.f. (cost, insurance, freight) unless otherwise specified.

Use of a dash (–) between dates representing years, e.g. 1981–1990, signifies the full period involved, including the initial and final years. An oblique stroke (/) between two years, e.g. 1991/92, signifies a fiscal or crop year.

The term "least developed country" (LDC) refers, throughout this report, to a country included in the United Nations list of least developed countries.

In the tables:

Two dots (..) indicate that the data are not available, or are not separately reported.

One dot (.) indicates that the data are not applicable.

A hyphen (-) indicates that the amount is nil or negligible.

Details and percentages do not necessarily add up to totals, because of rounding.

Abbreviations

AFD	Agence Française de Développement
AfDF	African Development Fund
AGOA	African Growth and Opportunity Act
APQL	augmented physical quality of life
AsDF	Asian Development Fund
ASEAN	Association of Southeast Asian Nations
AUC	African Union Commission
CDM	Clean Development Mechanism
CDP	Committee for Development Policy
COP	Conference of the Parties to UNFCCC
COP21	twenty-first session of the Conference of the Parties to UNFCCC
CTCN	Climate Technology Centre and Network
DAC	OECD Development Assistance Committee
DFQF	duty-free quota-free
ECOSOC	United Nations Economic and Social Council
EDI	economic diversification index
EIF	Enhanced Integrated Framework
EITI	Extractive Industries Transparency Initiative
EPA	Economic Partnership Agreement
EVI	economic vulnerability index
FDI	foreign direct investment
FERDI	Fondation pour les Etudes et Recherches sur le Développement International
FFM	finance facilitation mechanism
G20	Group of Twenty
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCF	Green Climate Fund
GDP	gross domestic product
GEF	Global Environmental Facility
GNI	gross national income
GNP	gross national product
GSP	Generalized System of Preferences
GSTP	Global System of Trade Preferences
GVC	global value chain
HAI	human assets index
HS	Harmonized System
ICT	information and communications technology
IDA	International Development Association
IMF	International Monetary Fund
IPoA	Programme of Action for the Least Developed Countries for the Decade 2011–2020 (Istanbul Programme of Action)
ISM	international support measure

ITC	International Trade Centre
LDC	least developed country
LDCF	Least Developed Country Fund
LLDC	landlocked developing country
MIRAB	migration, remittances, foreign aid and public bureaucracy
MFN	most favoured nation
NAPA	national adaptation programme of action
NDE	national designated entity
NDP	national development plan
NTB	non-tariff barrier
NTM	non-tariff measure
ODA	official development assistance
ODC	other developing country
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PPP	purchasing power parity
PROFIT	people, resources, overseas management, finance and transport
PTA	preferential trade agreement
Quad	Canada, European Union, Japan, United States of America
SAMOA	SIDS Accelerated Modalities of Action
SDG	Sustainable Development Goal
SDT	special and differential treatment
SIDS	small island developing State(s)
SITE	small island tourist economy
SME	small and medium-sized enterprise
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
STI	science, technology and innovation
TNA	technology needs assessment
TRIMs Agreement	Agreement on Trade-related Investment Measures
TRIPS Agreement	Agreement on Trade-related Aspects of Intellectual Property Rights
UNCDF	United Nations Capital Development Fund
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNFCCC	United Nations Framework Convention on Climate Change
UNIDO	United Nations Industrial Development Organization
UNSGHLP	United Nations Secretary-General's High-Level Panel on the Technology Bank for the Least Developed Countries
UN-OHRLLS	United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

Classifications used in this Report

Least developed countries

Geographical/structural classification

Unless otherwise specified, in this Report the least developed countries (LDCs) are classified according to a combination of geographical and structural criteria. The small island LDCs that are geographically in Africa or Asia are thus grouped with the Pacific islands, due to their structural similarities. Haiti and Madagascar, which are regarded as large island States, are grouped with the African LDCs. South Sudan declared its independence on 9 July 2011, and became both an independent State and a United Nations Member State on 14 July 2011. Accordingly, starting with 2011, data for South Sudan and the Sudan, where available, are shown under the respective country name. For periods prior to the independence of South Sudan, data for the Sudan (former) include those for South Sudan unless otherwise indicated. The resulting groups are as follows:

African LDCs and Haiti: Angola, Benin, Burkina Faso, Burundi, the Central African Republic, Chad, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, the Niger, Rwanda, Senegal, Sierra Leone, Somalia, the Sudan (former) or South Sudan and the Sudan, Togo, Uganda, the United Republic of Tanzania, Zambia.

Asian LDCs: Afghanistan, Bangladesh, Bhutan, Cambodia, the Lao People's Democratic Republic, Myanmar, Nepal, Yemen.

Island LDCs: The Comoros, Kiribati, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu.

Graduation projection

This year's Report also classifies LDCs into two groups according to their graduation prospects, as follows. The methodology for reaching this group composition is explained in box 2.1 of chapter 2.

LDCs projected to graduate in the period 2017–2024: Afghanistan, Angola, Bangladesh, Bhutan, Djibouti, Equatorial Guinea, Kiribati, the Lao People's Democratic Republic, Myanmar, Nepal, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tuvalu, Vanuatu, Yemen.

Projected group of LDC by 2025: Benin, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, the Niger, Rwanda, Senegal, Sierra Leone, Somalia, South Sudan, the Sudan, Togo, Uganda, the United Republic of Tanzania, Zambia.

Export specialization

UNCTAD has classified the LDCs under six export specialization categories, according to which type of exports accounted for at least 45 per cent of total exports of goods and services in 2013–2015. The group composition is as follows:

Agricultural and food exporters: Guinea-Bissau, Malawi, Solomon Islands, Somalia*.

Fuel exporters: Angola, Chad, Equatorial Guinea, Yemen.

Manufactures exporters: Bangladesh, Bhutan, Cambodia, Haiti, Lesotho.

Mineral exporters: The Democratic Republic of the Congo, Guinea, Mali, Mauritania, Sierra Leone, Zambia.

Mixed exporters: Benin, Burkina Faso, Ethiopia, the Lao People's Democratic Republic, Liberia, Madagascar, Mozambique, Myanmar, the Niger, Senegal, the Sudan, Togo, the United Republic of Tanzania.

Services exporters: Afghanistan, Burundi, the Central African Republic, the Comoros, Djibouti, Eritrea, the Gambia, Kiribati, Nepal, Rwanda, Sao Tome and Principe, Timor-Leste, Tuvalu, Uganda, Vanuatu.

* No data for Somalia services exports are available.
No export data for South Sudan exports are available.

Other groups of countries and territories

Developed countries: Andorra, Australia, Austria, Belgium, Bermuda, Bulgaria, Canada, Croatia, Cyprus, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Greenland, Hungary, Iceland, Ireland, Italy, Israel, Japan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, San Marino, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland, United States of America, Holy See, Faeroe Islands, Gibraltar, Saint Pierre and Miquelon.

Other developing countries (ODCs): All developing countries (as classified by the United Nations) that are not LDCs.

Product classification

Goods: The figures provided below are the codes of the Standard International Trade Classification (SITC), revision 3.

Primary commodities: Sections 0, 1, 2, 3, 4, division 68 and groups 667 and 971.

Agriculture and food: Sections 0, 1, 2, and 4, excluding divisions 27 and 28.

Minerals: Divisions 27, 28, 68, and groups 667 and 971.

Fuels: Section 3.

Manufactures: Sections 5, 6 (excluding division 68 and group 667), 7 and 8.

Labour-intensive and resource-intensive manufactures: Divisions 61, 63, 64, 65, 82, 83, 84, 85, 66 (excluding group 667).

Low-skill- and technology-intensive manufactures: Divisions 67, 69 and groups 785, 786, 791, 793, 895, 899.

Medium-skill- and technology-intensive manufactures: Divisions 62, 71, 72, 73, 74, 77 (excluding group 776), 81, and groups 781 to 784, 893, 894.

High-skill- and technology-intensive manufactures: Section 5, divisions 75, 76, 87, 88 and groups 776, 792, 891, 892, 896, 897.

Section 9 (Commodities and transactions not classified elsewhere in the SITC) has been included only in the total of exports of goods and services, but not in the goods classification above, except for group 971 (Gold, non-monetary (excluding gold ores and concentrates)), which has been included in Minerals.

Services: Total services cover the following main categories: transport, travel, communications, construction, insurance, financial services, computer and information services, royalties and licence fees, other business services, personal, cultural, recreational and government services.

Overview



Deteriorating economic performance

Following several years of apparent resilience to the international economic and financial crisis, economic growth in the least developed countries (LDCs) has declined steeply since 2012, reaching a low of 3.6 per cent in 2015. This is the slowest pace of expansion this century, and far below the target rate of at least 7 per cent per annum recommended by the 2011 Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the so-called Istanbul Programme of Action (IPoA)). Thirteen LDCs experienced a decline in gross domestic product (GDP) per capita in 2015. This performance has been strongly influenced by the sharp decline in commodity prices, which has particularly affected African LDCs. Such weak economic growth is a serious obstacle to generating and mobilizing domestic resources for structural transformation and investment in the development of productive capacities. It also hampers progress towards the United Nations Sustainable Development Goals. This economic slowdown is likely to be reinforced by the current world economic climate, which remains lacklustre in its recovery.

Depressed exports as a result of falling commodity prices, with a smaller decline in imports, have also led to a doubling of the merchandise trade deficit of LDCs as a group from $36 billion in 2014 to $65 billion in 2015. The largest increase in the merchandise trade deficit took place in the subgroup of African LDCs and Haiti. The services trade deficit fell somewhat for the LDCs as a group, from $46 billion in 2014 to $39 billion in 2015, as a shrinking deficit across African LDCs and Haiti more than offset an increasing deficit across Asian and island LDCs. These developments largely account for an increase of almost one third in the LDC current account deficit to a record $68.6 billion in 2015, a trend that is expected to continue over the medium term.

Domestic resource mobilization has been recognized by the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and the 2030 Agenda for Sustainable Development (2030 Agenda) (both adopted in 2015) as an important process for LDCs to finance their development. However, this objective remains elusive for most LDCs due to their external resource gaps, the complexity of their development challenges, their narrow tax bases, deficiencies in tax collection and administration, resources forgone due to illicit financial flows, and the underdevelopment of their domestic financial sectors. The external resource gap of LDCs as a whole increased to 3.2 per cent of GDP in 2014, due mainly to an increase in fixed investment in Asian LDCs that was not accompanied by a corresponding rise in their domestic savings. If LDCs are to raise their fixed investment, as is essential for structural transformation, the deficit will inevitably widen in the coming years, particularly in view of the enormous financing needs associated with the Sustainable Development Goals.

The resources gap is financed by a mixture of official and private financial flows. Official development assistance (ODA) to LDCs declined by 12.2 per cent in 2014 to $26 billion — some 27 per cent of total aid to developing countries as a whole. Foreign direct investment (FDI), by contrast, rose by one third to $35 billion (9.5 per cent of the developing-country total), most being directed to African LDCs. Contrary to worldwide trends, workers' remittances to LDCs also rose in 2015, reaching $41.3 billion. They exceeded 20 per cent of GDP in the Comoros, Haiti, Liberia and Nepal.

The economic outlook for LDCs as a group for the next two years remains uncertain in the face of a lacklustre global economic environment that is depressed by weak demand in developed countries, a continuing slowdown of international trade, a sharp decline in growth or even recession in many developing countries, and high or rising debt in both developed and developing countries. In some LDCs, the prospects are aggravated by risks in the domestic political environment. Nevertheless, the real GDP growth of LDCs as a whole is forecast to recover somewhat to 4.5 per cent in 2016 and 5.7 per cent in 2017, though remaining below the IPoA target.

Graduation: A milestone, not the winning post

The IPoA includes a target that at least half of the LDCs should satisfy the criteria for graduation from LDC status by 2020. This was a bold step by the international community, putting LDC graduation firmly on the global agenda. The midpoint between the adoption of this target and the target date is an opportune time to evaluate the prospects for its fulfilment and to review the significance, nature and process of graduation.

Graduation is the process through which a country ceases to be an LDC and becomes one of what this Report terms "other developing countries" (ODCs). The significance of this step emerges from the rationale behind the LDC category itself. Its establishment in 1971 reflected a recognition that certain countries faced particularly serious

obstacles to achieving the structural transformation needed to advance economically and socially. The international community adopted special international support measures (ISMs) for LDCs to enable them to escape from the intersecting vicious circles that prevented their economic progress, and to derive developmental benefits from the global economy. This required the development of clear criteria to define which countries should be eligible for such measures.

There are three major vicious circles affecting LDCs. First, many LDCs suffer from a poverty trap, with low income and limited economic growth giving rise to high levels of poverty, which in turn act as a brake on economic growth. In spite of the progress achieved in the era of the Millennium Development Goals (2000–2015), it is in LDCs that poverty has been and remains most pervasive, with almost half of their total population still living in extreme poverty. Two thirds of the labour force of LDCs work in mostly smallholder agriculture, a sector suffering from chronically low labour productivity. Productivity growth has been constrained by the adverse impact of risk aversion on investment, and often by limits to access to and adoption of new technology.

Second, many LDCs suffer from a commodity trap, as they depend heavily on commodity production and trade for employment, income, savings and foreign exchange. In the overwhelming majority of LDCs (38 of the 47 for which data are available), commodities accounted for more than two thirds of merchandise exports in 2013–2015. Commodity dependence increases vulnerability to exogenous shocks (such as adverse terms of trade movements, extreme meteorological events and climate change impacts). It also often gives rise to a "natural resource curse", when exchange rate appreciation undermines the competitiveness of the manufacturing sector or when rent-seeking behaviour prevails, and there are limited incentives for public and private incentives to invest, even in human capital. Like poverty traps, commodity dependence tends to be persistent. LDCs face difficulties in upgrading within global value chains and are often kept locked into specialization in primary commodities and low-value-added products. With a few notable exceptions (Afghanistan, Burundi, the Comoros, Solomon Islands and Uganda), there is little evidence of a significant reduction in primary commodity dependence since the beginning of the century.

Third, weak productive bases and limited export diversification in LDCs give rise to a very high import content in production and consumption, and chronic current account deficits. These factors in turn result in aid dependence and the accumulation of foreign debt. These factors can also weigh heavily on the growth rate, as imports of capital goods and intermediate goods for investment projects may be reduced while essential imports such as food and fuels absorb the available foreign exchange.

Thus graduation, in principle, should mark the point at which an LDC has risen sufficiently from these vicious circles to rely primarily on its own strengths and on international markets for its subsequent development, without requiring the maximum concessionary treatment from development partners. In brief, graduation is normally expected to mark a move from economic dependence to a state of greater self-reliance.

Graduation from LDC status needs to be viewed as part of a longer and broader development process, in which economic growth should both result from and contribute to the development of productive capacities and a process of structural transformation. The latter entails an upgrade in the country's economic activities and helps to increase resilience to exogenous shocks.

Graduation is thus not the winning post of a race to cease being an LDC, but rather the first milestone in the marathon of development. It represents the end of a political and administrative process, in which the institutions responsible for inclusion in and exclusion from the group of LDCs take decisions based on statistical and other criteria. However, it does not mark the completion of an economic and developmental process.

Formally, an LDC is eligible to graduate if, in at least two consecutive triennial reviews of the list of LDCs by the Committee for Development Policy (CDP), it complies with one of two conditions: either it meets the graduation threshold of at least two of the three LDC criteria (gross national income (GNI) per capita, the human assets index (HAI) and the economic vulnerability index (EVI)); or it reaches a level of income per capita of at least double the graduation threshold for that criterion (the "income-only" graduation rule). The actual decision on graduation, however, does not follow mechanically from the satisfaction of these conditions: the specific circumstances of each country, especially its vulnerability, and the likely impact of graduation and the ensuing loss of LDC treatment are also taken into account.

In contrast to the ambition of the graduation target set by the IPoA, and contrary to expectations when the LDC category was established, the number of LDCs doubled from the original list of 25 in 1971 to a peak of 50 between 2003 and 2007, before decreasing to 48 in 2014. This partly reflects the fact that only four LDCs have graduated in the 45 years since the establishment of the category: Botswana (1994), Cabo Verde (2007), Maldives (2011) and Samoa (2014).

The limited number of graduations to date reflects a marked divergence of development paths among developing countries, with dynamic "emerging market economies" leaving the LDCs well behind in many respects. The per-capita income gap between LDCs on the one hand and ODCs and countries with economies in transition on the other has consistently widened since 1981. This divergence largely reflects the increasing gap in the productive capacities of the two groups, a gap mirrored by large differences in the social indicators.

The gap in social indicators is of particular importance in the context of the 2030 Agenda: as noted in previous *Least Developed Countries Reports*, LDCs will be the battleground on which the 2030 Agenda will be won or lost. Achieving the Sustainable Development Goals in LDCs will require major breakthroughs in the development of productive capacities, structural transformation, technological upgrading, economic diversification, productivity and job creation, some of which lie beyond the explicit targets of the Goals themselves. Thus, for LDCs to meet the Sustainable Development Goal targets in full would entail not only graduation in a formal sense, but graduation as part of a broader and longer-term process of economic transformation — what this Report terms "graduation with momentum".

The very limited number of LDC graduation cases to date is also in part indicative of major shifts in the international economic environment in recent decades, as market-based flows, especially of international trade and international investment, have increased in importance in the global economy. As a result, the success of developing countries has become increasingly dependent on fruitful engagement with export markets, particularly in higher-value segments of global value chains, including by means of appropriate strategic FDI policies. This gives rise to a growing need to compete, which intensifies the challenge posed by the widening gap in productive capacities between ODCs and LDCs. LDCs have been further disadvantaged by the relative decline in ODA, on which they are much more reliant than ODCs. The impact of the decreasing importance of ODA in international flows is compounded when the geographical allocation of aid does not benefit the neediest countries, and when its sectoral allocation is only weakly focused on the building of productive capacities.

The conceptualization of graduation as a milestone rather than a winning post has important implications for LDCs' approaches to development and to graduation. Just as it is inadvisable to sprint for the first kilometre of a marathon, it is not enough simply to target achievement of the criteria needed for graduation. It is also of paramount importance to establish the foundations needed to maintain development progress beyond graduation. This means approaching the graduation process with a view to longer-term development needs, rather than focusing only on the graduation criteria themselves. The latter approach risks diverting attention and resources from other aspects of development which, though not fully reflected in the criteria, will be critical long after graduation has been achieved.

Thus, the goal is not graduation per se, but graduation with momentum, which will allow the development trajectory to be maintained and pitfalls to be avoided far beyond graduation: in the long term, ***how*** a country graduates is at least as important as ***when*** it graduates. This indicates a need to move beyond graduation strategies oriented to the achievement of the graduation criteria, towards "graduation-plus" strategies directed to graduation with momentum and establishment of the conditions for a viable long-term development process.

While the development that leads a country to graduation is clearly beneficial, the loss of LDC status at graduation may give rise to potentially important economic costs as a result of the loss of access to the ISMs associated with LDC status. The magnitude of such costs depends on the extent to which the country concerned benefited from such measures before graduation. The need for ISMs is likely to be greatest at early stages of development, when the ability to compete in international markets is most limited. However, the potential to exploit and benefit from some ISMs, particularly preferential market access, largely depends on the level of productive capacities, which becomes higher as a country moves towards graduation. In a country where productive capacities expand in export sectors that are largely covered by trade preferences, and these preferences have been utilized, their loss may be a major cost. This highlights the importance of a smooth transition process in such cases, and of early preparation for the consequences of graduation as part of "graduation-plus" strategies.

National policy approaches to graduation depend not only on economic considerations but also on a political calculus of which the economic calculus forms a part. This includes the potential for a "kudos effect" domestically — the opportunity for a government to gain political advantage by claiming responsibility for having brought a country from LDC status to parity with other developing countries. Such considerations may have encouraged some LDC governments to develop strategies specifically oriented towards graduation by a specified date.

While some LDC governments resisted the idea of graduation during the 1990s and early 2000s, many now seem to take a much more positive view, interpreting reclassification as synonymous with irreversible progress and a

reflection of their proactive efforts to achieve such progress. This apparent change of attitude could in part reflect the political dividends offered by graduation, combined with the declining economic effectiveness of some of the ISMs.

The national dynamics of graduation

During the 45 years since the establishment of the LDC category, despite the domestic efforts of LDCs themselves and the impact of ISMs with the stated objective of strengthening their development processes, only four countries have succeeded in graduating from LDC status. This raises the question of why the development performance of LDCs has been so disappointing in both its domestic and international dimensions. Answering this question requires an understanding of the processes through which LDCs can exit from underdevelopment and achieve graduation.

To date, the countries which have achieved graduation comprise one landlocked mineral exporter in Africa (Botswana) and three small island economies that predominantly export services (Cabo Verde, Maldives and Samoa). For the purposes of this Report, a simulation was conducted to assess which LDCs were likely to graduate in the 2017–2024 period (without prejudging decisions by the CDP, the Economic and Social Council (ECOSOC) the United Nations General Assembly or LDCs themselves).

This exercise indicates that the number of graduations in the coming years is likely to fall well short of the IPoA target, showing only 10 countries as meeting the graduation criteria by 2020, against a target of 24. By 2025, only 16 countries are projected to have graduated. These 16 countries include all but one (the Comoros) of the seven small island LDCs and all but one (Cambodia) of the eight Asian LDCs, but only three (Angola, Equatorial Guinea and Djibouti) of the 33 LDCs in the Africa and Haiti group.

Despite their major structural handicaps (high environmental vulnerability due to high exposure to natural disasters, economic remoteness, smallness of domestic markets and a high dependence on ODA and remittances), small island developing States (SIDS) tend to perform relatively well in terms of graduation. This partly reflects their relatively large human asset endowments (reflecting their achievements in education and health) and high per-capita incomes (relative to other LDCs), although these positive features are counterbalanced by their high economic and environmental vulnerability.

Conversely, being landlocked presents many LDCs with additional challenges that are a greater obstacle to graduation. The landlocked developing countries (LLDCs) among the LDCs generally perform considerably less well than other LDCs, reflecting their more limited export diversification and productive capacities, lack of export competitiveness, economic remoteness and dependence on the economic and political situations of neighbouring (transit) countries. However, these challenges do not prevent some landlocked LDCs from achieving positive development outcomes or graduation, as attested by the first graduation case (Botswana) and the presence of four LLDCs among the LDCs projected to graduate before 2025.

While the structural handicaps outlined above may jeopardize structural transformation and development, the historical success of four LDCs in graduating and the projected future graduation cases demonstrate that neither underdevelopment traps nor disadvantageous geographical features are insurmountable obstacles to graduation. Successful development depends upon national and international policies and strategies that address the root causes of these underdevelopment traps, and kick-start the process of sustainable development.

None of the four ex-LDCs carried out policies with the explicit goal of graduation. Botswana's development policies were based on the efficient capture and use of mineral rents, and effective investment in education and physical infrastructure. The other three graduates (Cabo Verde, Maldives and Samoa) owe their graduation to sound policies to develop a competitive tourism sector and other services sectors (for example, offshore financial and legal services in Samoa), together with investment in the fisheries industry and in human capital. A strong influx of ODA and remittances was instrumental in supporting various forms of structural economic progress in Cabo Verde and Samoa.

The current LDCs, by contrast, tend to direct their strategies more explicitly towards graduation. Those countries that are close to graduation thresholds tend to adopt graduation as a major national goal and typically develop programmes targeting specific components of the graduation criteria. Often, the goal of graduation is set in the context of long-term development plans that aim at attaining the status of a middle-income country or even an "emerging market" economy.

Those LDCs that are further below graduation thresholds, by contrast, tend to aim at increasing per-capita income, and often implement strategies and programmes aimed at broad-based sustainable development. To that end, they typically focus on issues such as domestic resource mobilization, rural development, diversification of production and exports, raising productivity and increasing disaster preparedness.

UNCTAD's graduation projection exercise highlights the different growth and development paths that can lead to graduation. Some, but not all, of the 16 countries that are projected to have graduated by 2025 are likely to achieve graduation with momentum through broad-based development of productive capacities, diversification and structural economic transformation. This is the case for some manufactures exporters (Bangladesh and Bhutan) and mixed exporters (the Lao People's Democratic Republic and Myanmar). When graduation is achieved through a broader process of economic and social development, including progress towards structural transformation and economic diversification, it is likely to be more inclusive and to provide more solid foundations for continued development in the post-graduation phase.

However, by no means all graduates will achieve graduation with momentum: some LDCs are projected to reach graduation without having undergone meaningful structural economic transformation. This may be the case, in particular, for economies based on fuel extraction and, to some extent, SIDS. While fuel extraction boosts income, in most cases it does not lead to diversification or to commensurate social and economic inclusion, and does not necessarily provide a basis for sustainable development progress. Achieving these last goals requires policies and strategies to reinvest resource rents in productive-capacity development in other sectors beyond the extractive industries.

The past and projected graduation cases indicate that SIDS typically graduate through a combination of limited diversification towards services and investment in human capital. However, this is not enough for strong structural economic transformation, which requires a greater degree of diversification and advances towards higher-value-added sectors and activities.

The projections conducted for this Report have important implications for the composition of the LDC group over the next decade. In 2025, if the projections prove broadly correct:

- The LDC group would be composed of 32 countries, all but two (Cambodia and Haiti) in Africa;
- There would be only one SIDS (the Comoros), while coastal countries would represent a small majority of the total (17 of 32), only slightly outnumbering LLDCs (14);
- Commodities would continue to play a major role in the economy of the group as a whole; and
- The development challenges facing the group as a whole would be intensified, with greater reliance on agriculture for output and employment, higher poverty rates, low average labour productivity, and a higher degree of aid dependence. In the absence of more decisive and efficient development policies, the development gap between the remaining LDCs and ODCs would thus be even wider than at present, requiring heightened attention from both national authorities and the international community.

Differences in graduation performance highlight an increasing differentiation within the LDC group. While some LDCs are achieving visible progress in terms of building productive capacities, diversifying their economies and moving resources to higher-value-added sectors and products, others remain at the initial stage of these processes.

It is of utmost importance that the States and organs influencing or deciding the cases of graduation (LDCs themselves, the CDP, ECOSOC and the General Assembly) continue to take due account of factors other than statistical eligibility for graduation. Moreover, the possibility of graduation without structural transformation points to the need to reconsider the graduation criteria, and to reflect more fully the long-term development processes that these countries are undergoing.

The contribution of international support measures to graduation

The effectiveness of ISMs for LDCs is coming under greater scrutiny as growing emphasis is placed on the monitoring and evaluation of international support. This issue should be addressed in terms of the contribution of ISMs to enabling LDCs to overcome the structural handicaps and exit from the "traps" that limit their development of productive capacities and progress towards structural transformation — that is, in terms of their contribution to graduation with momentum.

ISMs for LDCs encompass a range of measures, commitments and provisions across the fields of development finance, trade, technology and technical assistance. The widening divergence between LDCs and ODCs in terms of income and productive capacities is indicative of shortcomings in their development models, strategies and policies, and/or of the ISMs that have been put in place in their favour. By making a greater contribution to the development of productive capacities in LDCs, more effective ISMs would have helped to limit the divergence between LDCs and ODCs. The failings of LDC-specific ISMs, in turn, reflect a combination of inappropriateness, diminishing effectiveness, insufficient funding, inadequate institutional settings and insufficient uptake.

There are 139 special and differential treatment (SDT) provisions benefiting developing countries (including LDCs) in the agreements of the World Trade Organization (WTO), of which 14 are specific to LDCs. Several decisions concerning LDCs have also been adopted since the inception of WTO. These provisions vary greatly in breadth, relevance and effectiveness. They have various objectives, notably to facilitate compliance with WTO rules, for example, through extended implementation periods. Some call on WTO members to provide assistance in various forms to LDCs; but these are generally limited to "best endeavour" language rather than being enforceable obligations. LDCs are also accorded some special rights with respect to protection and promotion of economic activities, allowing them somewhat greater policy space. However, the benefits of SDT provisions depend on awareness of their existence and terms, which varies widely among LDCs. Often LDC governments and firms do not make use of existing preferential measures (for example, flexibilities under the WTO Agreement on Trade-related Investment Measures (TRIMs Agreement) or under the WTO Agreement on Subsidies and Countervailing Measures) because they are not aware of them. Effective use of such preferential measures also depends on institutional capacities, financial resources and productive capacities.

Preferential market access is a major ISM available to LDCs, helping to offset the higher production and trade costs associated with their structural and geographical handicaps. While the majority of LDCs consider their major exports to be covered by duty-free quota-free (DFQF) schemes in developed countries, these often exclude some sensitive products in which LDCs have export capacity, such as clothing, textiles and some agricultural products. Although most existing preferential schemes cover the overwhelming majority of products, the exclusion of even a few tariff lines may entail huge losses, given the high concentration of LDC exports. Moreover, the benefits of duty-free market access have been progressively eroded as tariff levels more generally have declined, eroding preference margins.

Utilization of the preferences available is often limited by supply-side constraints, trade-policy-related obstacles (stringent rules of origin, low preference margins, product coverage and non-tariff barriers), lack of awareness, and the unpredictability of preferences due to their discretionary nature. However, the guidelines for preferential rules of origin for LDCs adopted at the Tenth WTO Ministerial Conference in December 2015, if implemented, could contribute substantially to easing this particular constraint on preference utilization. Preferences for LDCs in trade in services have also been permitted since December 2011, although the effective implementation and the expected commercial and developmental benefits of the so-called services waiver remain to be seen.

In the 2001 Doha Ministerial Declaration, WTO members agreed "to work to facilitate and accelerate negotiations with acceding least developed countries", and guidelines to this effect were operationalized in 2012. However, all the LDCs that have sought to join WTO since its creation have faced some degree of difficulty in the accession process, and there have been complaints from LDCs, individually and collectively, about the nature of the procedures and the demands that have been made on them in the course of negotiations.

Institutional constraints and limitations within LDCs are a key obstacle to their ability to use ISMs effectively, particularly in the trade arena. This makes trade-related technical assistance, notably through the Enhanced Integrated Framework (EIF), a particularly important ISM. Despite increasing support from the EIF, however, the IPoA target of increasing the share of LDCs in trade-related technical assistance has not been fulfilled: their share was no higher in 2014 than in 2011, when the IPoA was agreed.

The IPoA also repeated the targets of the Programme of Action for the Least Developed Countries for the Decade 2001–2010, adopted at the Third United Nations Conference of the Least Developed Countries in 2001, that donors should provide ODA to LDCs equivalent to 0.15–0.20 per cent of their GNI. The ratio for major donors as a whole more than doubled between 2001 and 2011. However, even at its peak the ratio was less than half the lower threshold, and it has since fallen back further. The gap between actual disbursements and the lower bound of the 0.15–0.20 per cent target has increased from $25 billion at the time of the IPoA (2011) to $30 billion in 2014. Available data also suggest limited progress on the 2001 commitment to increase the proportion of ODA to LDCs that is not tied to purchases from the donor country.

Climate change adaptation and mitigation need to play a central role in LDCs' development and graduation strategies. The United Nations Framework Convention on Climate Change (UNFCCC) recognizes the necessity of financial and technical support for their adaptation. However, while numerous funds have been established for adaptation, this has given rise to a complex architecture of multiple bilateral and multilateral agencies; some of the funds which exist remain seriously underfunded, and accessing funds is complex and time-consuming, particularly for countries such as LDCs with limited institutional capacity. The LDC Fund (LDCF), established in 2001, has financed the development of national adaptation programmes of action (NAPAs) in all but one (South Sudan) of the LDCs. However, total contributions to the LDCF remain below $1 billion, while the cost of implementing the NAPAs is estimated at $5 billion and expected to increase further over time. In October 2014, the LDCF was declared empty; and it remains to be seen how much of the pledges to climate funds made at the twenty-first session of the Conference of the Parties to the UNFCCC (COP21, held in 2015) will be forthcoming, and how much of this will be devoted to the LDCF.

Building technological capabilities is an essential component of sustainable development and of graduation with momentum. Nevertheless, existing ISMs make little contribution to technological upgrading in LDCs. These countries benefit from a waiver of most obligations under the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement) until 2021 (and 2033 for pharmaceuticals). However, the use of this waiver is restricted by TRIPS-plus obligations included in bilateral and regional trade and investment agreements, and by the low technological capabilities of LDCs. Under article 66.2 of TRIPS, developed countries are required to provide incentives for enterprises and institutions to promote technology transfer to LDCs; but in practice there have been very few effective measures taken in respect of this obligation. This ISM has therefore failed to provide a meaningful contribution to graduation with momentum.

Technology transfer also has a critical role in climate change adaptation and mitigation. During COP7 (held in Marrakesh in 2001), as part of the Marrakesh Accords, Parties to the UNFCCC established the Marrakesh Technology Framework, under which each LDC is expected to submit a technology needs assessment (TNA) to identify its mitigation and adaptation technology needs; and the COP has pledged to fund the production of such TNAs in full. As of 2015, however, only half of LDCs had submitted a TNA, and only nine had developed technology action plans as part of this process.

The major mechanism for climate-related technology transfer is the Clean Development Mechanism (CDM), which allows developed countries to meet their emissions-reduction obligations in part by financing emissions-reducing projects in developing countries using technologies unavailable in the host country. To date, however, such projects have been overwhelmingly located in more advanced developing countries (70 per cent in Brazil, China and India alone in 2010); and only 30 per cent of projects claim to offer technology transfer. By the end of 2012, there had been only 12 CDM projects in 7 LDCs.

To strengthen the technology component of the international support architecture to LDCs, the international community has decided to establish the United Nations Technology Bank for the Least Developed Countries. However, its effectiveness and contribution to graduation with momentum will only become apparent after the beginning of its operations, scheduled for 2017.

In the field of financing for development, ODA played an important role in the graduation of the four countries that have graduated to date. This partly reflects the small size of these countries (with populations of between 0.2 million and 1.5 million at the time of graduation) and the strong tendency for such small countries to receive much more ODA, both in per-capita terms and relative to GNI, than larger countries. Equally important for most of them, however, was the proactive approach their governments took to managing ODA receipts and orienting them towards their respective development plans. Trade-related ISMs played a much smaller role in these graduation cases, reflecting these countries' position as exporters mainly of primary commodities (Botswana) or services (Cabo Verde, Maldives and Samoa). However, Maldives benefited from preferential access to the European Union market for its fish exports.

To deepen the understanding of the perceived effectiveness of ISMs by present LDCs, UNCTAD has carried out a survey of LDC officials. The results suggest that they consider ISMs insufficient to support development challenges in LDCs, while also confirming that institutional capacity is an important constraint to LDCs' ability to make effective use of ISMs. Most respondents reported the use of one or more SDT provisions, although this varied widely across provisions. Preferential market access, flexibilities in commitments and the EIF are widely used, while little utilization was reported of SDT provisions relating to agreements on TRIMs, sanitary and phytosanitary measures, and technical barriers to trade. The survey also indicated that LDCs face difficulties in the WTO accession process, in making use of existing flexibilities, and in participating in negotiations.

Respondents generally considered access to development finance insufficient to achieve the IPoA targets, but most saw aid management policies as having improved. However, particular concern was raised about the effectiveness of technology-related ISMs, respondents citing limited technology transfer and difficulties in tracing it to ISMs. While growing international recognition of LDCs' needs in the context of climate change was acknowledged, concerns were expressed about the wide disparity between funding pledges and actual contributions, additionality to ODA, lack of technical capacity in LDCs and lack of systematic information about the funds.

Overall, existing ISMs remain largely inadequate to the developmental needs of the LDCs, making a limited contribution to the development of LDC productive capacities or to the acceleration of their progress towards graduation. The shortcomings of ISMs have become more critical in light of the ambitious targets of the 2030 Agenda and the IPoA. The effectiveness of the existing ISMs is undermined, to varying degrees, by vague formulation, non-enforceability of commitments, insufficient funding, slow operationalization and exogenous developments in international trade and finance. A viable institutional framework and a concrete operational mandate closely aligned with LDCs' needs and developmental interests are essential to effectiveness. Nonetheless, the experiences of past LDC graduates and the views of some current LDCs suggest that some of the existing ISMs can play an important role in supporting graduation. This applies particularly to preferential market access for those LDCs that can make most use of it, and to ODA to small economies.

However, the contribution of ISMs to LDC graduation and development depends critically on the institutional capacities of each individual LDC and its ability to leverage the available mechanisms strategically in pursuit of its own development and graduation agenda. It is thus critical that institutional capacity constraints are taken into account in the design of ISMs, including by combining the establishment of these measures with the provision of related technical assistance.

Post-graduation processes and challenges

An LDC's prospects for sustainable development after it has graduated are strongly influenced by the processes that lead it to graduation, including its economic specialization or diversification, the type of structural transformation it undergoes, and the policies it puts in place. While graduation from the LDC category in principle indicates greater resilience and/or reduced exposure to structural vulnerabilities, graduates can be expected to remain more vulnerable than other developing countries, not least as a result of geographical challenges such as landlocked position, small size and remoteness. It is thus imperative that such long-term challenges should be taken into account in the design and implementation of national graduation strategies, to avoid the risk of recurrent shocks when the country no longer has access to LDC-specific support measures.

Following graduation, there is a "smooth transition" period of up to nine years from the effective date of graduation, during which LDC-specific support is phased out gradually and predictably so as to avoid disrupting the country's development progress. While many trading partners (for example, the European Union) have adopted a policy of extending their LDC-specific trade preferences for a transition period, this is not the case for all LDCs' development partners. Moreover, there is little clarity regarding smooth transition procedures for other ISMs, such as ODA allocations, aid modalities and technical assistance. The absence of a systematic approach to smooth transition means that the ability of a graduating country to make use of SDT provisions following graduation is heavily dependent on its ability and efforts to mobilize technical, financial and political support from its trading partners, and from bilateral and multilateral development partners.

The full costs of graduation are felt only once the smooth transition period has elapsed. A broad assessment of the economic implications of LDC graduation suggests that the phasing out of LDC-specific support ultimately entails some adverse effects and additional costs, but that the related losses are in most cases relatively limited and should not be exaggerated. Moreover, graduates can typically benefit from other support measures (such as different financing windows and SDT provisions for ODCs) that provide a certain degree of continued support, though less generous than those accorded to them before graduation.

In relation to development financing, there is in principle little reason why LDC graduation should, in itself, have any effect on private capital flows such as remittances and portfolio investment. Graduation (or the prospect of graduation) may discourage FDI inflows motivated by preferential market access that may be lost as a result. However, most FDI flows are shaped primarily by long-term trends in macroeconomic fundamentals and institutional development (notably economic growth, domestic market, labour force qualification, technological capabilities), which ultimately underpin the process of graduation itself.

Concerning ODA, there is little evidence of a positive "LDC effect" on aid allocations, notwithstanding the LDC-specific ODA target. Aid allocations are dictated not only by the needs of recipient countries, but also — especially in the case of bilateral donors — by donors' strategic and political considerations. A different issue arises in the case of multilateral donors, many of which have formal eligibility criteria for their concessional windows. The International Development Association (IDA) of the World Bank — the largest multilateral funder of LDCs — defines eligibility essentially on the basis of a threshold level of GNI per capita, which is close to the LDC graduation threshold. The IDA eligibility criteria are also largely applied by the regional development banks for Africa, Asia and the Americas.

Graduation of an LDC is unlikely to trigger sharp changes in its access to development finance, although it may entail some increase in its cost by reducing its concessionality. Similarly, there is little reason to expect graduation to trigger a sudden decline in Aid-for-Trade financing, especially since the main LDC-specific programme, the EIF, already has well-established procedures for smooth transition. Overall, concerns over the costs of graduation in terms of reduced access to concessional financing upon graduation seem to be exaggerated.

In the international trade arena, the main implication of LDC graduation is the phasing out of SDT provisions favouring LDCs, leading (according to the particular agreement or arrangement) either to less favourable SDT provisions available to ODCs, or in some instances standard provisions for all non-LDC economies. Of particular importance in this respect is the loss of preferential market access under LDC-specific schemes (such as the European Union's Everything But Arms Initiative and the concessions granted to the LDCs under the Global System of Trade Preferences among Developing Countries).

For the purposes of this Report, a simulation was conducted of the potential consequences for LDCs of losing their trade-preference margins in the main G20 (Group 20) markets. This found that the loss of LDC-specific preferential treatment in the G20 countries is on average equivalent to a 3–4 per cent reduction in merchandise export revenues, depending how the preference margin is computed. Extrapolating this result to all 48 LDCs suggests that the loss of preferential market access to the G20 countries might reduce total LDC merchandise exports by more than $4.2 billion per year. The greatest effect would be on those exports for which tariffs are generally highest for non-LDCs, namely agricultural commodities, apparel and textiles, while effects on exports of energy products, mining and ores, and wood products would be limited, as these products face relatively low tariffs regardless of LDC status.

In the context of WTO, graduation could entail some erosion of policy space, for example, in relation to intellectual property rights, industrial policy (TRIMs) and agricultural subsidies, as well as requiring some adjustments to the country's legal framework to comply with the newly applicable WTO discipline (for example, putting in place full TRIPS compliance). Early efforts to map and address such adjustments are advisable. In this context, it is important, ahead of graduation, to anticipate post-graduation challenges and devise appropriate coping strategies to limit their adverse impacts.

Beyond the immediate adjustment to the loss of access to ISMs, LDCs also need to be forward-looking, in order to plan for the broader development challenges typical of the post-graduation phase. Such challenges include, in particular, commodity dependence, the risk of reversion to LDC status, and the "middle-income trap".

Commodity dependence is expected to remain a major feature of many LDC graduates, as it is for many lower-middle income ODCs. Commodities make a major contribution to the exports of the graduates of 2017–2024, except for the manufactures exporters (Bangladesh and Bhutan) and the service exporters (Nepal, Sao Tome and Principe, and Vanuatu); and there is no assurance that they will escape commodity dependence or the associated challenges.

Reversion to LDC status is at least a theoretical possibility, despite the existing precautions (such as different thresholds for inclusion in and exclusion from the category, grace period, smooth transition and consideration of country circumstances). Some countries may graduate by narrowly meeting the graduation thresholds without having acquired sufficient resilience or built a sufficiently solid and diversified productive base to ensure the sustainability of their development progress. While no graduating country has ever reverted to LDC status, the risk of such an outcome is increased by the likelihood of a difficult global economic environment in the coming years and by the prospect of intensifying impacts of climate change, to which some LDCs are particularly vulnerable.

While the likelihood of reversion to LDC status is at present limited, the risk of graduates of falling into a middle-income trap at some point after graduation is much greater. The various characterizations of the middle-income trap — limited likelihood of transition to a higher income group, lack of income convergence towards a benchmark advanced country, and frequency of growth slowdowns — closely mirror phenomena typically experienced by LDCs. Avoiding the middle-income trap after graduation requires anticipation of its underlying causes in the pre-graduation period and achieving the structural transformation that characterizes graduation with momentum.

The path to graduation and beyond

This Report advocates that LDCs should approach the quest for graduation from the perspective of the development of productive capacities in order to achieve graduation with momentum. This means giving the highest priority to structural transformation of the economy and development of productive capacities, including shifting production and exports to higher-value-added products and sectors, upgrading technology, diversifying the economy and raising productivity. This view mirrors the Sustainable Development Goals, not only in explicitly addressing structural transformation and industrialization, but also in emphasizing the need for an integrated approach in which the social pillar of sustainable development is complemented by strong economic and environmental pillars.

The graduation-with-momentum perspective entails targeting longer-term development and the processes that underlie it, rather than focusing narrowly on the graduation criteria and adopting measures aimed at achieving statistical eligibility for graduation. If development strategies are underpinned by such a broader and longer-term sustainable development perspective, this will allow the graduation criteria to be met, as well as achieving the structural transformation central to graduation with momentum.

Graduation is a milestone in a long-term socioeconomic development process, not the winning post in a race to leave the LDC group. It marks only the end of an initial stage of development, at which point LDC-specific ISMs are phased out. The development process, essentially rooted in a sustainable expansion of productive capacities and increased sophistication of the productive base, continues indefinitely beyond this point, and development challenges do not cease to exist at a particular level of income. The importance of such a perspective is highlighted by the challenges faced by countries at more advanced stages of the development process as a result of constraints on the development of productive capacities or failures of structural transformation, notably the middle-income trap.

The key importance of attaining graduation with momentum, rather than simply graduating, indicates a need to move from graduation strategies focused on satisfying the statistical graduation criteria to what this Report calls "graduation-plus" strategies, aimed also at establishing the foundations for a continuing development process beyond the graduation milestone. This implies mobilizing different instruments and planning techniques for addressing macroeconomic and sectoral development challenges. While these instruments must clearly reflect national specificities and priorities, certain types of policies are likely to feature in any effective graduation-plus strategy. This Report groups such policies into six areas for action, while highlighting gender as a cross-cutting issue.

Rural transformation: As highlighted in *The Least Developed Countries Report 2015*, structural transformation in LDCs cannot overlook the key role of rural development. Redressing chronic underinvestment in agriculture remains a key priority for most, if not all, LDCs, and requires building essential infrastructure, upgrading farming technologies and practices, and developing agricultural research and development and effective extension services. Rural economic diversification, through the development of non-farm activities, has an important complementary role.

Industrial policy: The main objective of industrial policy is to "nudge" economic agents to bring about a shift from lower- to higher-productivity sectors and activities, exploiting more intensively those sectors that are consistent with current comparative advantage, while also encouraging the expansion of sectors of a somewhat higher level of sophistication. It is therefore essential that industrial policy is coordinated and creates synergies with policies for science, technology and innovation (STI).

STI policy: To support and advance the process of structural transformation, LDCs' technological capabilities need to be strengthened by reinforcing the absorptive capacity of their firms and farms. This includes strengthening their capacity to absorb and master superior technologies from more advanced countries (whether developed or developing). This, in turn, requires improvement in the international system for technology transfer to LDCs. Domestically, STI policies need to reinforce local and regional research and development, especially in agriculture, as well as to be coherent with education policy.

Finance: Transformative productive investment and technological upgrading are crucial to increase labour productivity within sectors and to promote productivity-enhancing structural change; and finance plays a key role in mobilizing resources, both domestic and foreign, and intermediating them effectively to these ends. Beyond the traditional banking sector, considerable opportunities for domestic resource mobilization are opening up for LDCs through innovative financial instruments relying on the increasing penetration of information and communications technologies (ICTs), notably mobile banking and money transfer services.

Macroeconomic policies: Sound macroeconomic fundamentals are a necessary condition for the smooth working of the economy, but are not by themselves sufficient to spur structural transformation. Graduation with momentum requires considerable scaling up of capital accumulation; and fiscal policy has a key role to play in this context, notably through public investment that can crowd in additional private investment. Large-scale infrastructural projects addressing bottlenecks in productive sectors can achieve this, by relaxing supply-side constraints which hamper the private sector. Increasing the available fiscal space requires both improving taxation and revenue collection systems and diversifying public revenue sources. It also requires addressing the challenge of illicit financial flows, which besets fuel- and mineral-exporting countries in particular.

Employment generation: Graduation with momentum requires LDC economies to generate jobs on a substantially larger scale than in the recent past, to allow productive employment of the growing cohorts of new entrants to the labour market and thereby reap the demographic dividend. To reach these goals, the process of structural transformation should be steered so as to include the adoption of labour-intensive technologies, especially in sectors such as agriculture, manufacturing and infrastructure.

Gender: Structural transformation and development of productive capacities cannot be fully effective unless they empower women to develop their potential economic contribution to a much greater extent than at present. This requires gender considerations to be taken fully into account in all areas of policy. Such an approach could also be adopted in the formulation of the LDC criteria, where gender balance could become an additional component of the human assets index.

The international environment and international support measures

The international community has a central role to play in facilitating the path of LDCs to graduation with momentum. This means, first, ensuring a stable and conducive international economic environment; and second, designing and implementing ISMs that contribute effectively to strengthening the process of graduation with momentum.

With respect to the first aspect, a major priority, the urgency of which UNCTAD has repeatedly emphasized, is to ensure a more conducive international financial system, to reduce the frequency of crises and ensure the financing of productive investment in both developed and developing countries, as well as to cater for the particular vulnerabilities and concerns of LDCs. A more supportive international environment, in the run-up to graduation and beyond, would also include strengthening regional integration and forging stronger trade and financial partnerships within the global South.

Similarly, UNCTAD has long stressed the importance of adopting measures to stabilize international commodity markets, for example through improvements in commodity market regulation. More predictable and less volatile commodity markets would facilitate the mobilization of resource rents for the development of productive capacities by reducing the uncertainty of LDC export revenues and the negative impact on current account balances of sharp fluctuations in terms of trade.

The current architecture of ISMs is not conducive to the achievement of the Sustainable Development Goals, especially in the LDCs. While the effectiveness of ISMs such as ODA and preferential market access has been eroded in recent years, the need for effective ISMs remains, particularly in view of the widening gap between LDCs and ODCs — a gap which is likely to widen further in the light of current trends. ISMs need to be designed to take into account both changing international conditions and the changing features and conditions of the LDC group.

In particular, development-financing practices need to be better suited to supporting structural transformation and resilience-building activities in both LDCs and recently graduated countries. ODA is the main source of external financing to LDCs, amounting to $47 per person and some 5 per cent of GNI on average in 2014. The Sustainable Development Goals and the IPoA objectives will thus not be fully achieved unless: (a) ODA to LDCs is increased at least sufficiently to meet the international target of 0.15–0.2 per cent of donor countries GNI; and (b) all donors allocate at least 50 per cent of net ODA to LDCs (as foreseen in paragraph 52 of the Addis Ababa Action Agenda). This is particularly important to those countries expected to make up the LDC group in 2025, which will need to benefit disproportionately from such increases in light of their underdevelopment and poverty. Therefore, the quantitative targets for ODA to LDCs should be kept intact even as the group shrinks, in view of the greater needs of the remaining LDCs. Moreover, in line with the strategy of graduation with momentum and with the approach of the 2030 Agenda, donors would raise aid effectiveness by rebalancing their aid allocation towards supporting the development of productive capacities.

Blended finance, combining ODA, philanthropic funds and other public or private development finance flows, may offer a versatile means of mobilizing and leveraging private resources. Other financial instruments, such as GDP-indexed bonds, countercyclical loans and weather insurance, may also have a role to play in helping LDCs to manage risk and vulnerability to shocks more effectively.

An LDC finance facilitation mechanism: The proliferation of separate institutions and financing windows, together with limited progress towards donor coordination and harmonization, has given rise to an increasingly complex development finance architecture for LDCs. To improve their access to development (and, for example, climate) finance, this Report proposes the establishment of an LDC finance facilitation mechanism (FFM). The FFM could serve as a "one-stop shop", identifying appropriate funding agencies for the investments identified as priorities in LDCs' national development strategies by matching them with the particular criteria, priorities and preferences of potential funding sources. This could considerably reduce the administrative burden of seeking development finance, while accelerating access to finance and reducing funding uncertainty. Such benefits could be further enhanced by providing support to the preparation of funding applications and fulfilment of reporting requirements; and an appropriately designed FFM could also contribute substantially to capacity-building in LDCs. An appropriate structure and adequate funding and staffing would be essential to the effectiveness of such a mechanism. In view of its long-standing work on financing for development and on LDCs, UNCTAD could play a useful role as a member of the board of the FFM, which would decide its priorities, policies and practices.

Trade: In the area of trade, preferential market access is one of the most effective ISMs in favour of LDCs, even though not all countries have adopted DFQF schemes for LDCs, and the coverage of existing DFQF arrangements is incomplete. Achieving 100 per cent DFQF coverage would certainly represent an important step towards the IPoA/Sustainable Development Goal target of doubling LDCs' share in global exports. Equally, one of the priorities of a successful smooth transition strategy should be to ensure that graduating countries retain some degree of preferential access in key export markets through other unilateral preference schemes or bilateral or regional agreements. From a longer-term perspective, however, the strategic value of preferential market access should not be overemphasized.

It is important that preference-granting partners review their rules of origin in accordance with the WTO Ministerial Decision on Preferential Rules of Origin for Least Developed Countries, originally adopted at the Bali Ministerial Conference in 2013 in the form of a "best endeavour" clause. It is also important to capitalize on the ongoing efforts to streamline non-tariff measures — especially in the field of agricultural goods — and to converge, to the extent possible, towards commonly accepted international standards, to reduce compliance costs.

Greater progress is needed towards operationalizing the LDC services waiver, to enable LDCs to take greater advantage of the expansion of international trade in services. Enhancing the commercial value of the preferences under the waiver and increasing the number of preference-granting countries could represent significant steps in favour of a number of LDCs, particularly island LDCs.

Technology: LDCs could harness more fully such policy space as is available to them through bolder and more strategic industrial policy frameworks including in the field of technology. Appropriate STI policy frameworks, for example, could help LDCs to reap some of the strategic opportunities offered by the extension of the transition period for their implementation of the TRIPS Agreement, particularly if combined with more effective support for technology transfer under its article 66.2.

The international framework will start to work for technology transfer, rather than focusing mainly on the protection of intellectual property, if developed countries comply with their obligation under article 66.2 of the TRIPS Agreement to foster technology transfer to LDCs. In order to reach this goal, the following measures could be considered.

- The WTO TRIPS Council could implement its 2003 decision to review the monitoring system for developed countries' compliance with their obligations under article 66.2. It could require developed countries to report, in a standard format, comparable information on programmes and policies relating to activities corresponding to a previously agreed definition of technology transfer. LDCs could play an active role by reporting on the extent to which technology transfer is contributing to their building a sound and viable technological base.
- Developed countries are advised to focus on sectors and activities where technology transfer is not profitable for technology owners due to low absorptive capacity in the receiving country, and where technologies correspond to local entrepreneurial demands in LDCs, where they have a high social return.
- Institutionally, developed countries could consider funding specialized agents that link developed country donors, private firms holding a given technology and entrepreneurs in LDCs to ensure the effectiveness of technology transfer operations.

The United Nations Technology Bank can become an instrument to foster the development of technological capabilities of LDCs if:

- It has a monitoring mechanism that ensures that the ultimate objective of helping LDCs to build a solid and viable technological base is being achieved;
- It is adequately funded, especially as it expands its activities;
- It gives priority to the transfer of technology (including intellectual-property-free technologies); and
- It adjusts technical assistance to LDCs in the management of their intellectual property systems according to the type of system most appropriate to their level of economic and institutional development.

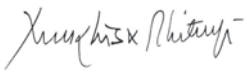
Inputs for reconsidering LDC criteria: The effectiveness of the current graduation criteria in capturing the extent to which LDCs have overcome the structural impediments to development is open to debate. Particular issues are raised by the potential for LDCs to graduate without having advanced in structural transformation and the failure of any LDC graduate to date to achieve the graduation threshold for the EVI — arguably the most suitable of the three criteria to capture structural vulnerabilities.

Such issues have given rise to calls for revisions of the criteria and graduation thresholds used to define the LDC category. Issues which the CDP might consider in this context include:

- Incorporation, to the extent possible, of the Sustainable Development Goals and the 2030 Agenda;
- Incorporation of the perspective of graduation with momentum, so as to embed graduation in a long-term process of sustainable development;
- Enhanced measurement of structural transformation;
- Enhanced environmental criteria, including consideration of climate change and related vulnerabilities.

More specific approaches which the CDP might consider include the following:

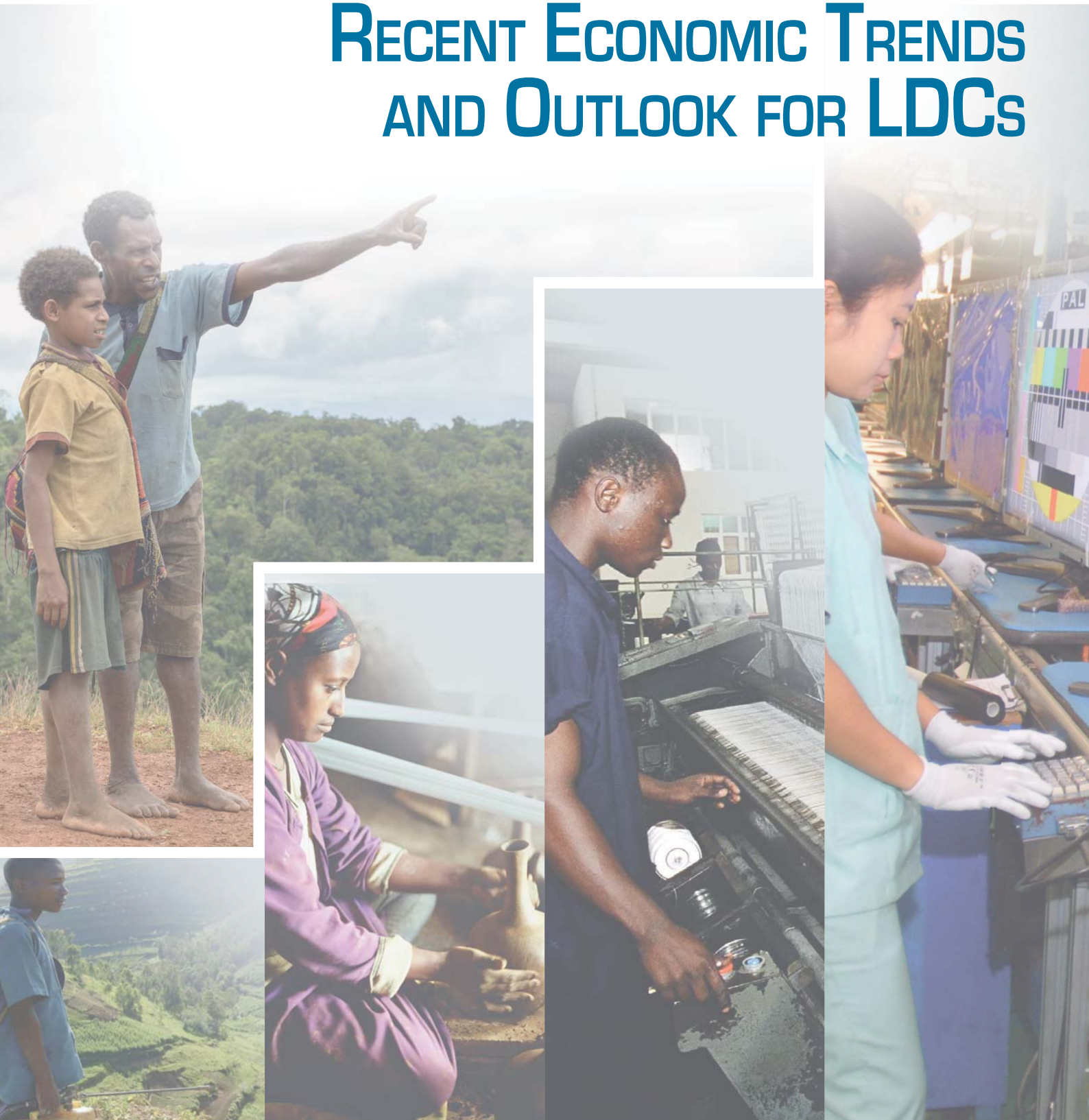
- A “vulnerability ceiling”: In addition to satisfying the existing criteria, a graduating country could be required to have an EVI of no more than half of the graduation threshold level;
- Adjustment of the composition and computation of the EVI: The exposure index could be improved by giving less weight to geographical challenges, such as size and remoteness, and more to those reflecting structural transformation and environmental considerations; replacing the share of agriculture, fisheries and forestry in production with a composite index of structural transformation; and replacing the environmental subindex with one or more indices better reflecting LDCs’ particular environmental concerns and vulnerabilities, particularly those related to climate change; and
- Separate indices: A more far-reaching proposal, in line with the concept of graduation with momentum, would be to separate the structural transformation and environmental dimensions and build separate indices. The structural transformation index could also be made a mandatory condition for graduation.



Dr. Mukhisa Kituyi
Secretary-General of UNCTAD

INTRODUCTION

RECENT ECONOMIC TRENDS AND OUTLOOK FOR LDCS



A. Introduction

After having apparently shown resilience for some years to the international economic and financial crisis, economic growth in the least developed countries (LDCs) has declined steeply since 2012, reaching a low of 3.6 per cent in 2015. This is by far the slowest pace of expansion this century and it is far below the targeted rate of at least 7 per cent per annum recommended in the 2011 Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the Istanbul Programme of Action (IPoA)). Such a low economic growth rate renders it difficult to generate and mobilize domestic resources to sustain efforts at structural transformation and the building of productive capacities through investment. By the same token, it also slows down the progression of countries towards graduation out of the LDC category, which is analysed in detail in this Report. The growth slowdown is likely to be reinforced by the current world economic climate, which continues to be characterized by a sluggish recovery.

Since 2012, LDCs' growth has slowed dramatically to the lowest rate this century.

The merchandise trade deficit among LDCs as a group almost doubled from $36 billion in 2014 to $65 billion in 2015. The negative trade balance increased among all LDC subgroups except for island LDCs. The services trade deficit fell somewhat for the LDCs as a whole, from $46 billion in 2014 to $39 billion in 2015. This is the result of the shrinking deficit of African LDCs, which more than compensated the widening experienced by Asian and island LDCs.

This chapter provides an overview of LDCs' recent performance in terms of economic growth (section B), foreign trade and current account balance (section C), and domestic and external financing (section D). Section E concludes with a brief review of the outlook for LDCs, especially for 2016 and 2017.

B. The real sector

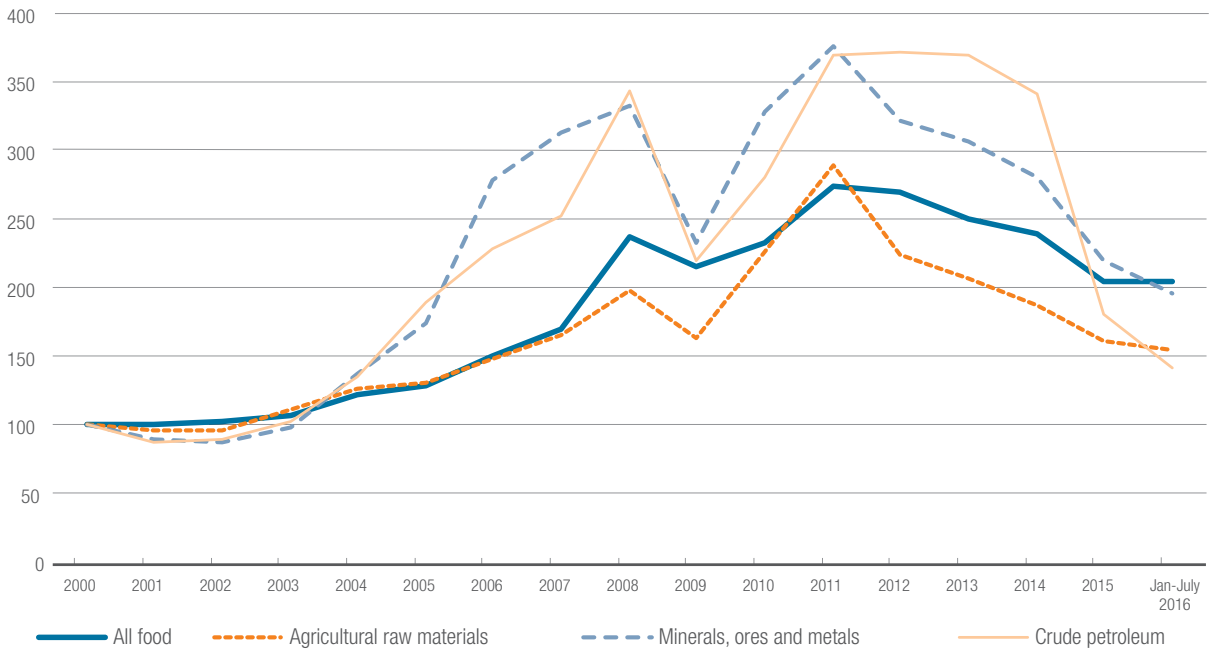
Economic growth (measured as growth in real gross domestic product (GDP) at constant 2005 prices) slowed down to 3.6 per cent in 2015 in LDCs as a group, which is a sharp drop from the growth performances recorded in the years before the 2009 crisis and the lowest growth rate since 1994.[1] Between 2008 and 2015 the economic growth rate of the group surpassed the 7 per cent per annum benchmark, as recommended in the IPoA, only once, in 2012.[2] Much of this weak performance can be attributed to the preponderance in the group of African LDCs, which are primarily commodity dependent, and thus vulnerable to falling commodity prices. Figure Intro.1 depicts the evolution of commodity prices by type of commodity for the period 2000–2016.

Commodity prices fell significantly in 2015, oil plunged 47.2 per cent.

Crude oil prices plunged by 47.2 per cent in 2015, having previously fallen by 7.5 per cent in 2014. This was accompanied across the board by significant drops in prices of other commodities such as minerals, ores and metals, and agricultural raw materials and food, confirming a downward trend in prices that started in 2012. The fall in demand for primary commodities is partly explained by China's strategic reorientation towards consumption-led growth, while the general economic slowdown worldwide further compounded the downward trend in primary commodity prices. Global growth continues to be stifled by weak demand in developed economies, reflecting a falling wage share and insufficient household demand, which have not been offset by higher investment spending (UNCTAD, 2016b).

Table Intro.1 also shows the economic growth rate of LDCs based on their export specialization. Fuel exporters were the only group to have contracted

Figure Intro.1. Evolution of commodity prices by type, 2000–2016
(Indices, 2000 = 100)



Source: UNCTADstat database (accessed July 2016).

in 2015, by a hefty 4.5 per cent, reflecting the strong exposure of primary-commodity-dependent economies to the boom–bust price cycles that afflict primary commodity markets (which is discussed in chapter 2 of this Report). In fact, the other main commodity-specialized LDC groups (food and agricultural exporters and mineral exporters) also experienced a sharp decline in their growth rates, expanding by less than 4 per cent in 2015. By contrast, LDCs that are mainly exporters of manufactures achieved the highest economic growth rate in 2015 at 6.2 per cent, higher than the rates recorded by other developing countries (ODCs; that is, non-LDC developing countries) and by developing countries as a whole.

Growth performance in 2015 varied widely among export groups.

Table Intro.1. Real GDP growth rates in LDCs, other developing countries and developed countries, 2002–2017
(Per cent)

	2002–2008	2012	2013	2014	2015	2016	2017
Total LDCs	**7.4**	**7.1**	**6.1**	**5.6**	**3.6**	**4.5**	**5.7**
African LDCs and Haiti	7.9	7.4	6.1	5.6	4.1	3.7	4.8
Asian LDCs	6.7	6.5	6.1	5.7	2.9	5.9	7.0
Island LDCs	3.9	5.2	2.9	4.3	3.3	4.4	4.8
LDCs by export specialization:							
Agricultural and food exporters	5.6	1.7	4.5	5.1	3.2	3.2	4.0
Fuel exporters	11.6	5.0	4.9	3.5	-4.5	1.1	3.6
Mineral exporters	6.0	5.9	6.6	6.7	3.8	4.4	4.7
Manufactures exporters	6.3	6.2	6.0	6.2	6.2	6.4	6.8
Services exporters	5.8	6.4	2.8	4.2	3.9	3.6	4.9
Mixed exporters	7.1	4.5	6.6	6.5	6.2	5.7	6.2
Other developing countries	**6.9**	**4.9**	**4.8**	**4.4**	**3.9**	**3.8**	**4.3**
All developing countries	**6.9**	**5.0**	**4.8**	**4.5**	**3.9**	**3.8**	**4.4**
Developed countries	**2.4**	**1.1**	**1.0**	**1.7**	**1.9**	**1.8**	**1.9**

Source: UNCTAD secretariat calculations, based on data from IMF, World Economic Outlook database (accessed May 2016).
Notes: Data for 2015 are preliminary; those for 2016 and 2017 are forecasts.
For the classificaiton of LDCs according to their export specialization, see p.xiii.
"All developing countries" consists of LDCs and other developing countries.

African LDCs suffered more from the shock in primary commodity prices than Asian LDCs due to their greater dependence on primary commodity exports. Their economic performance was also influenced by other exogenous shocks, such as exposure to disease outbreaks, which aggravated the situation for some African LDCs. Four of them (Burundi, Equatorial Guinea, Sierra Leone and South Sudan) experienced a contraction in their real GDP, while it stagnated in two others (Guinea and Liberia). In Asia, Yemen experienced a deep slump in GDP (-28.1 per cent), due to the situation of armed conflict, while among islands Vanuatu experienced a fall in GDP of 0.8 per cent, having been adversely impacted by a series of natural disasters since 2014. By contrast, the highest economic growth rate among all LDCs in 2015 was in Ethiopia (10.2 per cent), followed by the Democratic Republic of the Congo, Bhutan, Myanmar, the Lao People's Democratic Republic and the United Republic of Tanzania, all of which grew by at least 7 per cent in 2015.

The fall in primary commodity prices particularly affected African LDCs.

The weak economic performance of many LDCs means that their average per-capita GDP growth tumbled to 1.5 per cent in 2015, from 3.3 per cent in the previous year. Thirteen of the 47 LDCs for which data are available experienced a contraction in per-capita income, which exceeded 10 per cent in three cases (Equatorial Guinea, Sierra Leone and Yemen).

LDCs' per capita growth slowed to 1.5 per cent in 2015.

Given this weak economic performance, it is likely that progress towards poverty reduction and other Sustainable Development Goals has slowed down in many LDCs. In 2015 nominal GDP per capita ranged from $221 in South Sudan to $11,768 in Equatorial Guinea. Seventeen LDCs out of 47 for which data were available had a GDP per capita above $1,200 in 2015. Nine LDCs, all African, had a GDP per capita below $500 (Burundi, the Central African Republic, the Democratic Republic of the Congo, the Gambia, Liberia, Madagascar, Malawi, the Niger and South Sudan); 19 LDCs had a GDP per capita in the range of $500 to $1,000; 16 LDCs in the range of $1,000 to $2,900 and three LDCs stood above $2,900 (Angola, Equatorial Guinea and Vanuatu). Unsurprisingly, all of the countries in the last group, but none of the lowest-income group, are expected to graduate out of the LDC category before 2025 (as discussed in chapter 2 of this Report).

GDP per capita was below $500 in nine LDCs in 2015, and above $2,900 in three.

C. Current account and international trade

1. Current account balance[3]

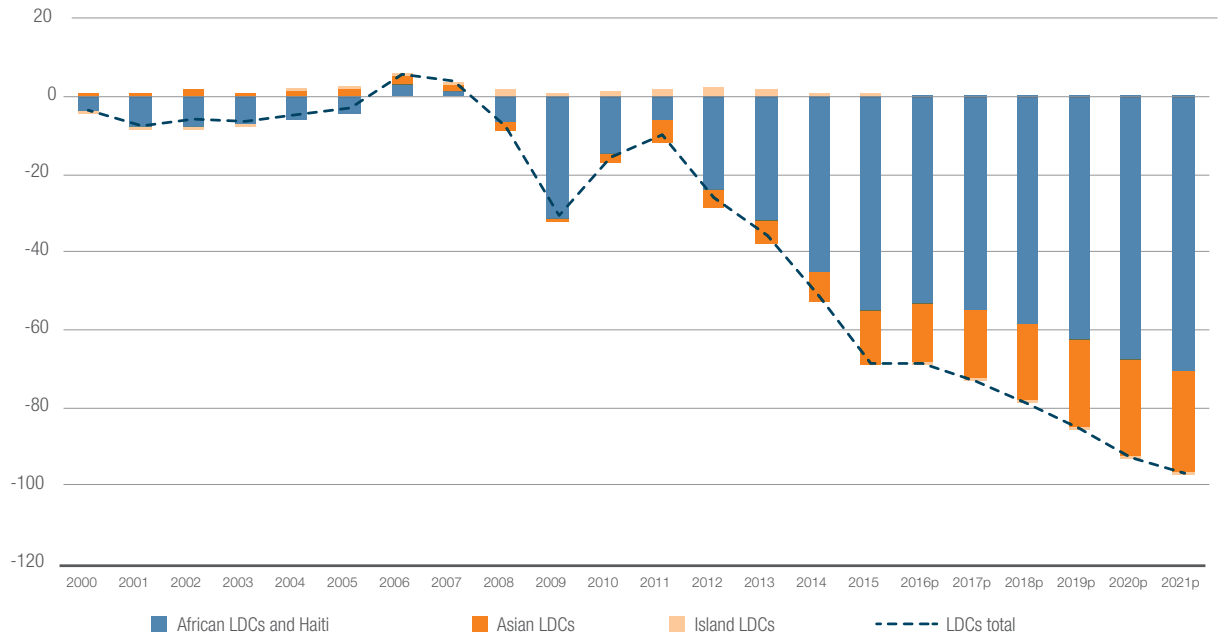
In 2015 the LDCs as a group registered a record current account deficit of $68.6 billion, a strong increase of one third over 2014 (figure Intro.2). This stands in contrast with ODCs, all developing countries and developed countries, which as groups registered current account surpluses.

Island LDCs were the only LDC subgroup that experienced a current account surplus in 2015, albeit representing a decrease of 68 per cent compared to their 2014 surplus. The current account deficit of the African LDCs and Haiti amounted to $55.3 billion, an increase of 22.1 per cent compared with 2014. The Asian LDCs registered a current account deficit of $13.8 billion, representing a near doubling vis-à-vis the deficit of 2014.

LDCs' total current account deficit rose by one third in 2015, to a record level of $68.6 billion ...

These aggregate figures must be interpreted with caution, however. All African LDCs recorded current account deficits in 2015, but among island LDCs Kiribati and Timor-Leste alone accounted for the current account surplus of the island LDC grouping. In Kiribati, there was an increase in revenues from fishing licences on the services export side,[4] which also contributed to economic growth

Figure Intro.2. Current account balance of LDCs, 2000–2021
(Billions of current dollars)



Source: UNCTAD secretariat calculations, based on data from IMF, World Economic Outlook database (accessed July 2016).
Note: p=projected.

and rising public revenues, while in Timor-Leste a modest growth in exports of oil and gas was accompanied by a slight fall in services exports. Among Asian LDCs, Afghanistan and Nepal had current account surpluses in 2015, partly as a result of a weakening of import demand in both countries.

…and all African LDCs had current account deficits...

Falling commodity prices adversely affected the export earnings mainly of primary-commodity-dependent African LDCs. Mozambique had the highest current account deficit as a share of GDP in 2015 at 41.3 per cent (figure Intro.3), while Kiribati at the other end of the scale had the largest current account surplus as a share of GDP at 45.7 per cent. Depressed external demand in 2015, reflecting weak economic growth among both developed and developing economies, contributed to the persistent current account deficits of many LDCs, as export demand in LDCs was stymied by worldwide conditions, while imports remained buoyant in the face of persistent production constraints and narrow trade bases. The current account deficits of LDCs were also fuelled by the appreciation of the dollar on world markets.

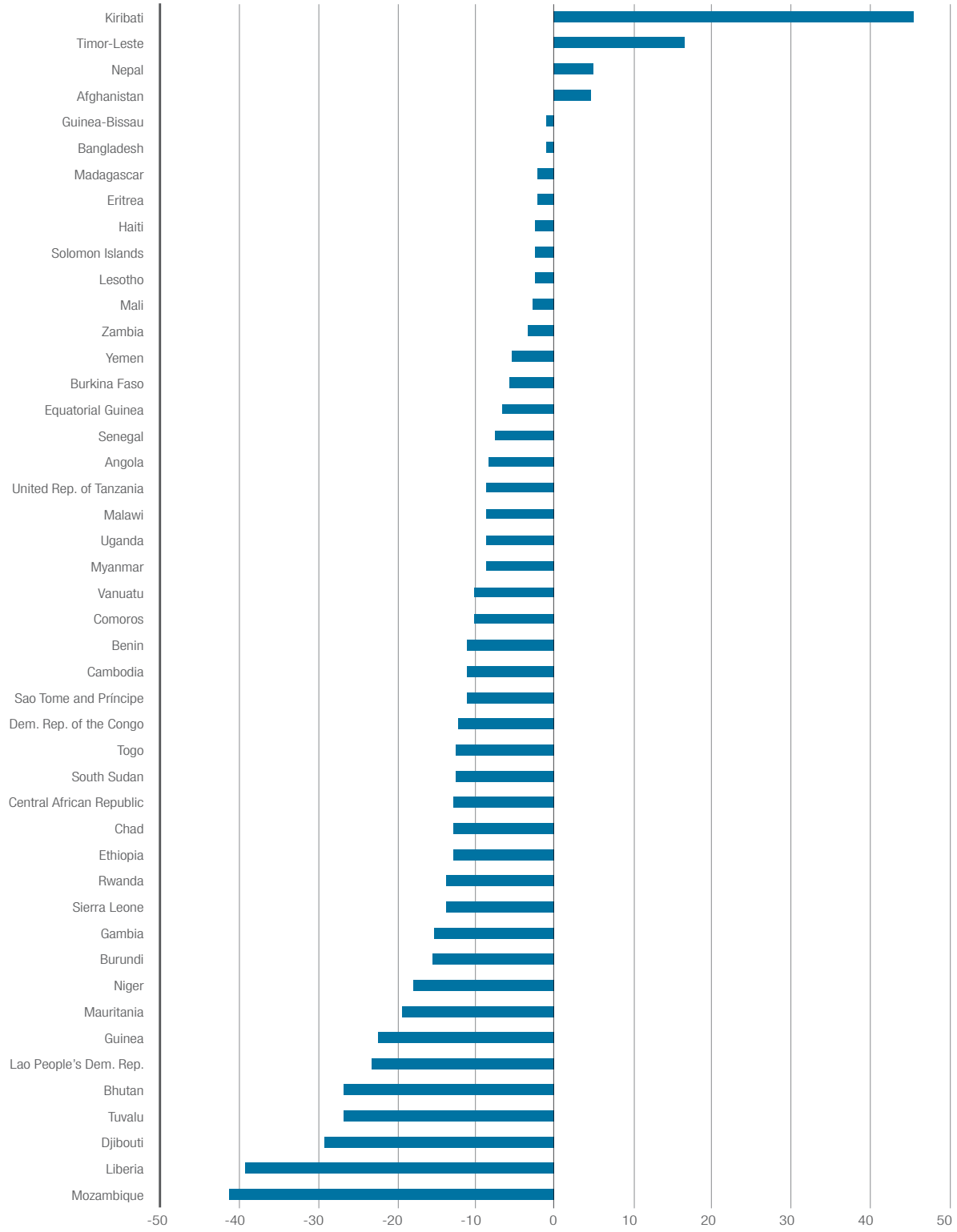
2. Trade in goods and services[5]

…reflecting depressed external demand, weak commodity prices, dollar appreciation and production constraints.

Global trade growth slowed down to a five-year low in 2015 according to estimates by UNCTAD and the World Trade Organization (UNCTAD and WTO, 2016). They show that, measured in current dollars, global merchandise exports plummeted by 13 per cent in 2015. Services exports declined by 6 per cent. Developed and developing economies appeared similarly affected by the decline of merchandise exports in 2015, with falls of 12 per cent and 13 per cent, respectively. The sharpest reductions were experienced by the principal petroleum exporters (-37 per cent), while major exporters of manufactured goods and of non-fuel commodities were less affected (-5 per cent).

The estimated fall in exports for the LDC group during 2015 was quite severe and not at all compensated by the developments in their imports. Total exports

Figure Intro.3. Current account balance as a percentage of GDP, 2015



Source: UNCTAD secretariat calculations, based on data from IMF, World Economic Outlook database (accessed July 2016).

LDC exports of goods and services fell by 20.2 per cent to $201 billion in 2015.

of goods and services of this group of countries amounted to $201 billion in 2015 at current prices, a decrease of 20.2 per cent from $252 billion in 2014, itself a small decline from the post-2000 peak of $256 billion, achieved in 2013. All LDC groupings experienced a fall in total exports of goods and services. The decline was most pronounced among the primarily commodity-export-dependent group of African LDCs and Haiti and least pronounced among the services-export-oriented group of island LDCs (table Intro.2).

Table Intro.2. LDC exports and imports of goods and services, 2005–2015, selected years
(Millions of current dollars)

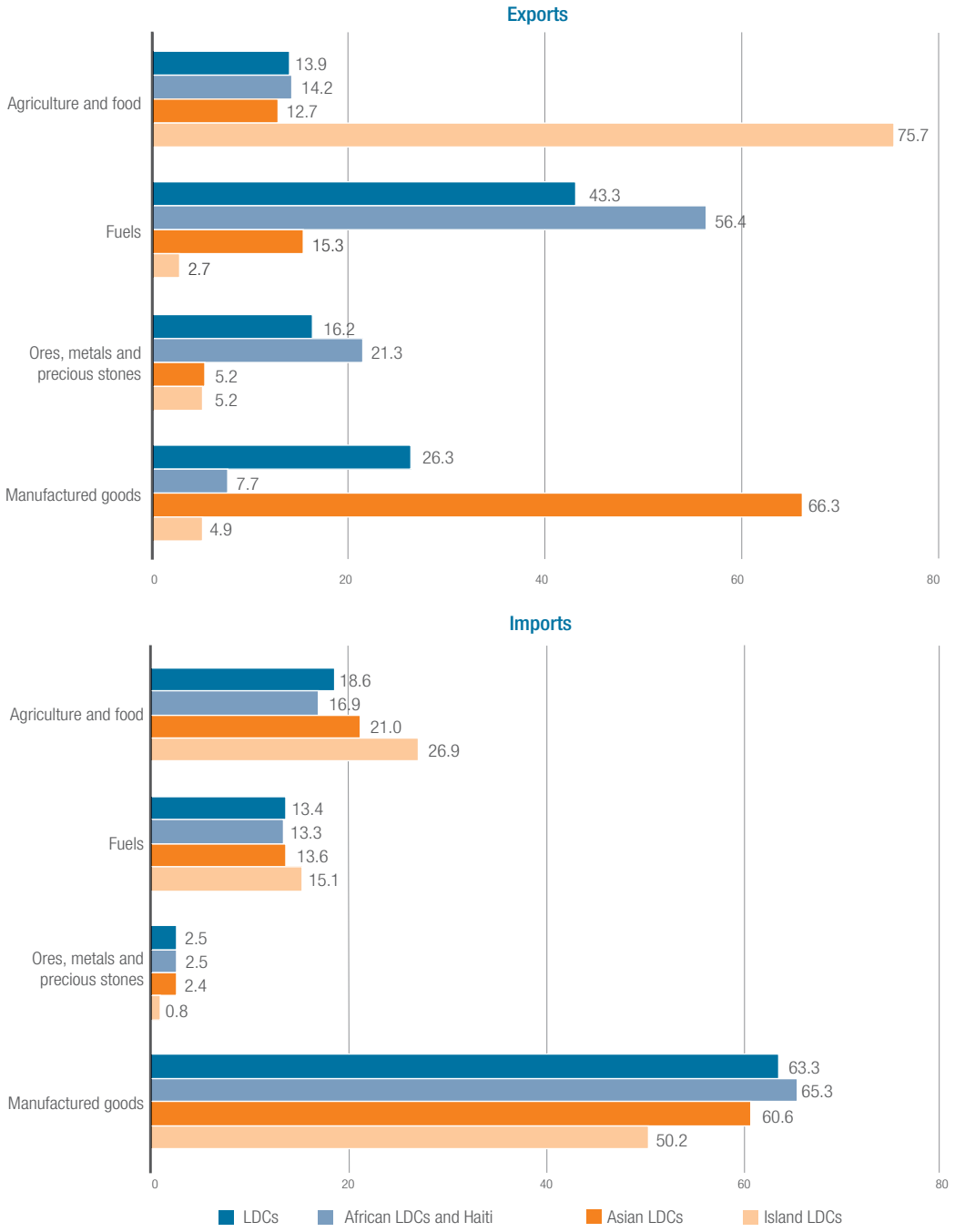
		2005	2006	2010	2013	2014	2015	% change (2014–2015)
Total trade in goods and services								
Exports	LDCs	95 892	117 795	190 934	255 864	251 842	200 905	-20.2
	African LDCs and Haiti	66 919	83 769	138 522	183 813	175 296	131 951	-24.7
	Asian LDCs	28 549	33 545	51 530	70 806	75 254	67 755	-10.0
	Island LDCs	424	481	882	1 244	1 292	1 199	-7.2
Imports	LDCs	108 319	125 101	220 519	312 908	333 518	305 083	-8.5
	African LDCs and Haiti	73 094	83 765	151 278	210 631	221 764	190 199	-14.2
	Asian LDCs	34 334	40 168	66 416	99 218	108 666	111 888	3.0
	Island LDCs	892	1 168	2 826	3 058	3 087	2 996	-3.0
Trade balance	LDCs	-12 427	-7 306	-29 585	-57 044	-81 675	-104 178	27.6
	African LDCs and Haiti	-6 175	4	-12 755	-26 818	-46 468	-58 249	25.4
	Asian LDCs	-5 784	-6 623	-14 886	-28 411	-33 412	-44 133	32.1
	Island LDCs	-468	-687	-1 944	-1 814	-1 795	-1 796	0.1
Total trade in services								
Exports	LDCs	12 030	14 070	24 390	36 880	39 820	40 330	1.3
	African LDCs and Haiti	7 840	9 150	14 020	22 140	22 730	22 740	0.0
	Asian LDCs	3 940	4 620	9 840	14 060	16 390	16 940	3.4
	Island LDCs	250	300	530	680	690	640	-7.2
Imports	LDCs	28 330	33 160	61 450	81 020	85 900	79 550	-7.4
	African LDCs and Haiti	22 720	26 200	48 940	63 330	66 540	58 460	-12.1
	Asian LDCs	5 370	6 470	10 960	16 540	18 270	19 940	9.1
	Island LDCs	240	490	1 550	1 150	1 090	1 140	4.6
Trade balance	LDCs	-16 300	-19 090	-37 060	-44 140	-46 080	-39 220	-14.9
	African LDCs and Haiti	-14 880	-17 050	-34 920	-41 190	-43 810	-35 720	-18.5
	Asian LDCs	-1 430	-1 850	-1 120	-2 480	-1 880	-3 000	59.6
	Island LDCs	10	-190	-1 020	-470	-400	-500	25.0
Total trade in goods								
Exports	LDCs	83 862	103 725	166 544	218 984	212 022	160 575	-24.3
	African LDCs and Haiti	59 079	74 619	124 502	161 673	152 566	109 211	-28.4
	Asian LDCs	24 609	28 925	41 690	56 746	58 864	50 815	-13.7
	Island LDCs	174	181	352	564	602	559	-7.1
Imports	LDCs	79 989	91 941	159 069	231 888	247 618	225 533	-8.9
	African LDCs and Haiti	50 374	57 565	102 338	147 301	155 224	131 739	-15.1
	Asian LDCs	28 964	33 698	55 456	82 678	90 396	91 948	1.7
	Island LDCs	652	678	1 276	1 908	1 997	1 856	-7.1
Trade balance	LDCs	3 873	11 784	7 475	-12 904	-35 595	-64 958	82.5
	African LDCs and Haiti	8 705	17 054	22 165	14 372	-2 658	-22 529	747.6
	Asian LDCs	-4 354	-4 773	-13 766	-25 931	-31 532	-41 133	30.4
	Island LDCs	-478	-497	-924	-1 344	-1 395	-1 296	-7.1

Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

Imports of goods and services also contracted for the LDC group, falling from $334 billion in 2014 to $305 billion in 2015. However, the decline in imports was not enough to outweigh the decrease in export earnings, so that the trade balance deficit in goods and services rose in nominal terms from $82 billion in 2014 to $104 billion in 2015. The trade balance deficit in goods and services rose fastest among Asian LDCs from 2014 to 2015 (32.1 per cent), while it was virtually stagnant in island LDCs.

Differences in trade structures and composition matter. Countries that are primarily commodity export dependent, mostly in the African LDCs and Haiti group, experienced a severe deterioration in their merchandise trade deficit in 2015, which grew by a factor of more than eight in nominal terms. In this group of countries, fuels, ores, metals, precious stones and gold accounted in 2015 for 77.7 per cent of merchandise exports, whereas they accounted for 59.5 per cent among LDCs as a group, only 20.5 per cent among Asian LDCs and only 7.9 per cent among island LDCs (figure Intro.4). By contrast, the primarily services-export-oriented island LDCs group experienced a slight improvement in its merchandise trade deficit (a nominal decrease of 7.1 per cent), matched by a manageable increase in its services trade deficit (a nominal increase of 25 per cent).

Figure Intro.4. Composition of LDCs' merchandise exports and imports, 2015
(Per cent)



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

The merchandise trade deficit among LDCs as a group almost doubled from $36 billion in 2014 to $65 billion in 2015. It widened among all LDC subgroups except for island LDCs. The services trade deficit fell among LDCs as a group from $46 billion in 2014 to $39 billion in 2015. It narrowed among African LDCs but widened in Asian and island LDCs from 2014 to 2015 (table Intro.2).

LDC merchandise trade deficit almost doubled from $36 billion to $65 billion.

In relation to trade, the IPoA sets a major target for LDCs of doubling the share of LDCs in global exports by 2020. Data from the UNCTADstat database reveal that the LDC share of global exports of goods and services rose from 0.75 per cent in 2005 to 0.96 per cent in 2015. These low figures highlight the serious challenges to competitiveness faced by LDCs, and their important deficits in productive and institutional capacities, as discussed in the remainder of this Report. Between 2011 and 2015, LDCs' share in global exports of goods and services actually fell from 1.05 per cent to 0.96 per cent, which implies that, since the adoption of the IPoA, LDCs have been unable even to prevent their share of global exports from declining.

LDCs' share in global exports fell from 1.05 per cent in 2011 to 0.96 per cent in 2015.

D. Resource mobilization

1. Domestic resource mobilization

Domestic resource mobilization was also identified as a priority area for action in the IPoA, and has since been recognized by the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and the 2030 Agenda for Sustainable Development (2030 Agenda) (both adopted in 2015) as an important process for LDCs to finance their development.

However, this objective remains elusive for most LDCs due to their external resource gaps, the complexity of their development challenges, their narrow tax bases, deficiencies in tax collection and administration, resources forgone due to illicit financial flows, and the underdevelopment of their domestic financial sectors.

LDCs' external resource gap averaged 3.2 per cent of GDP in 2014, narrowing in Asian LDCs but widening in the Africa and Haiti group.

The external resource gap of LDCs as a group (that is, the difference between the gross fixed capital formation rate and the gross domestic savings rate) averaged 3.2 per cent of GDP in 2014.[6] There are, however, variations among LDC subgroups (table Intro.3). From 2013 to 2014, gross fixed capital formation rate fell slightly in African LDCs and Haiti from 25.7 per cent to 25.5 per cent of GDP, while their gross domestic savings rate rose marginally from 24.0 per cent to 24.2 per cent of GDP, thereby narrowing the external resource gap for this group slightly to 1.3 per cent of GDP. Among Asian LDCs, on the other hand, the external resource gap rose to 7.2 per cent of GDP. This was mainly the result of the increase in their gross fixed capital formation rate (from 26.5 per cent to 27.8 per cent of GDP) outweighing the rise in their gross domestic savings rate from 20.3 per cent to 20.6 per cent of GDP.

Table Intro.3. Gross fixed capital formation, gross domestic savings and external resource gap in LDCs
(Per cent of GDP)

	Gross fixed capital formation				Gross domestic savings				External resource gap			
	2002–2008	*2012*	*2013*	*2014*	*2002–2008*	*2012*	*2013*	*2014*	*2002–2008*	*2012*	*2013*	*2014*
LDCs (total)	**22.2**	**26.6**	**25.9**	**26.2**	**20.0**	**23.3**	**22.9**	**23.0**	**-2.2**	**-3.3**	**-3.0**	**-3.2**
African LDCs and Haiti	22.5	27.2	25.7	25.5	21.7	24.2	24.0	24.2	-0.8	-3.0	-1.7	-1.3
Asian LDCs	22.0	26.1	26.5	27.8	16.4	20.9	20.3	20.6	-5.6	-5.2	-6.2	-7.2
Islands LDCs	12.1	13.7	13.1	14.1	33.7	50.5	41.8	40.9	21.5	36.8	28.7	26.8

Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

As a group, island LDCs face an external resource surplus (rather than a gap) of 26.8 per cent of GDP. However, this aggregate number can be misleading as it reflects exclusively the savings–investment surplus of Timor-Leste. The other six island LDCs (the Comoros, Kiribati, Sao Tome and Principe, Solomon Islands, Tuvalu and Vanuatu) all have gross fixed capital formation rates that exceed their gross domestic savings rates by margins ranging from 2.6 per cent of GDP in Vanuatu to 82.9 per cent in Kiribati.

Reducing illicit financial flows and mobilizing diaspora savings can generate additional resources for development.

If LDCs maintain their efforts to boost domestic investment rates, in order to accelerate structural transformation and the achievement of the Sustainable Development Goals, their investment–savings gaps are likely to grow further. How investment–savings gaps are financed will have important implications for the indebtedness of LDCs, especially in Africa (UNCTAD, 2016a). LDCs will need to diversify the sources of their development finance away from debt and official development assistance (ODA) towards alternative and innovative sources of finance, potentially including the mobilization of diaspora savings (UNCTAD, 2011) and the tackling of illicit financial flows. For instance, according to the United Nations High-level Panel on Illicit Financial Flows, illicit financial flows out of Africa could potentially amount to $50 billion a year, approximately double the continent's ODA receipts (UNECA, 2015). Another study indicates that illicit financial flows from LDCs accounted for around 4.8 per cent of GDP in 2008 (Kar, 2011). Policies to mobilize domestic resources in LDCs need to integrate concrete measures to tackle illicit financial flows, which is the other side of the coin of mobilizing development finance in LDCs.

2. Official capital flows

LDCs continue to finance their external resource gap through a mixture of official development financing[7] — including ODA — and private resource flows such as foreign direct investment (FDI) and remittances.

Net ODA fell by 12.2 per cent in real terms in 2014.

Total net ODA disbursed to developing countries amounted to $95 billion in 2014. Total net ODA to LDCs in 2014 amounted to $26 billion,[8] representing an estimated 27.1 per cent of total ODA to developing countries, down from 31.2 per cent in 2013 (figure Intro.5). Despite the commitments made by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD DAC) donors that they would not reduce ODA to LDCs and that they would allocate 0.15–0.20 per cent of their gross national income to these countries, it is to be noted that net ODA to LDCs fell in real terms by 12.2 per cent from 2013 to 2014. Preliminary estimates indicate that bilateral aid to LDCs was $25 billion in 2015 (OECD, 2016).

The eight largest recipients of ODA in 2014 were Afghanistan ($3.9 billion), Ethiopia ($1.9 billion), South Sudan ($1.6 billion), the United Republic of Tanzania ($1.5 billion), Mozambique ($1.4 billion), Bangladesh ($1.4 million), the Democratic Republic of the Congo ($1.2 billion) and Myanmar ($1.2 billion).

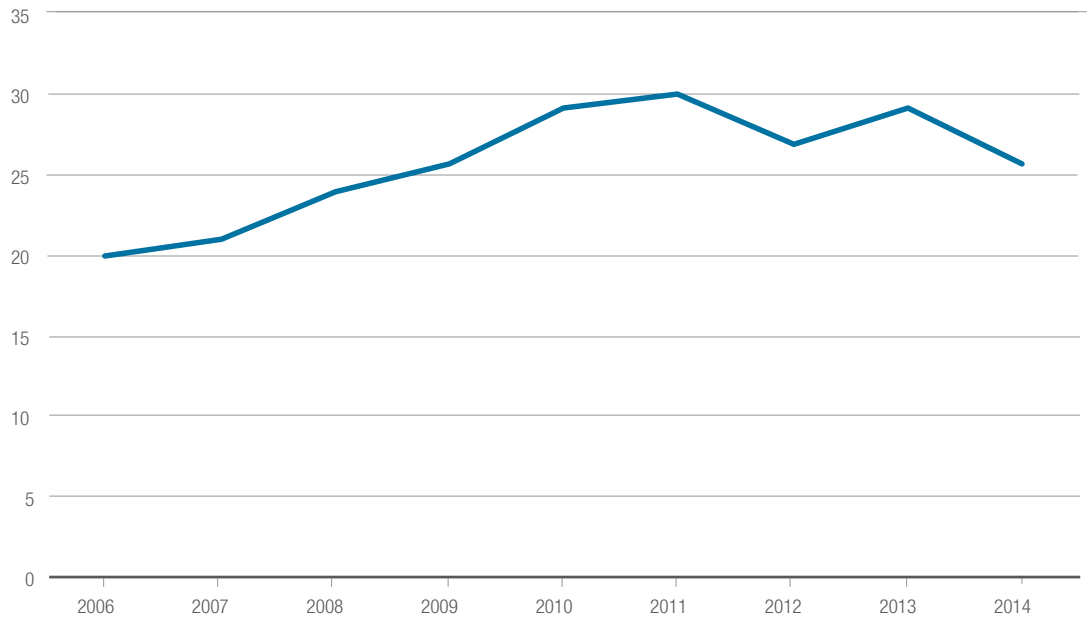
Inflows of FDI increased by one third in 2015, to $35 billion…

The four largest increases in ODA disbursed (in real terms) from 2013 to 2014 occurred in the Central African Republic (+151.5 per cent), followed by Sierra Leone (+146.7 per cent), Liberia (+132.9 per cent) and South Sudan (+42.7 per cent), representing for the most part emergency and humanitarian aid in the face of a crisis. The four largest declines in ODA disbursed in real terms from 2013 to 2014 took place in Lesotho (-74.0 per cent), Myanmar (-66.4 per cent), the Sudan (-50.8 per cent) and Angola (-35.8 per cent).

3. Foreign direct investment

Inflows of FDI to LDCs as a group amounted to $35 billion in 2015, a one-third increase over the previous year (table Intro.4). The growth of FDI inflows

Figure Intro.5. Net ODA disbursed for LDCs, 2006–2014
(Billions of constant 2014 dollars)



Source: OECD International Development Statistics (IDS) database (accessed July 2016).
Note: The latest year for which data are available is 2014. Excludes amounts allocated to unspecified developing countries.

Table Intro.4. FDI inflows into LDCs, 2002–2015
(Millions of dollars)

Category	2002–2008 (annual average)	2010	2013	2014	2015
LDCs (total)	**10 939.3**	**23 762.9**	**21 366.4**	**26 311.2**	**35 107.1**
African LDCs and Haiti	8 402.2	13 690.0	16 767.7	22 952.7	28 067.3
Asian LDCs	2 430.3	9 765.7	4 503.2	3 266.2	6 910.7
Islands LDCs	106.9	307.1	95.4	92.3	129.1

Source: UNCTAD secretariat calculations, based on data from the UNCTAD FDI/MNE database (www.unctad.org/fdistatistics) (accessed July 2016).

to LDCs far outpaced that of inflows to all developing countries (+9.5 per cent), where they increased from $698 billion in 2014 to $765 billion in 2015. The share of LDCs in FDI flows to developing economies as a whole has been relatively stable since 2010, and reached 4.6 per cent in 2015. It is imperative for LDCs to pursue strategic policies to tap into the development potential of global FDI as a complementary source of development finance as part of their national development strategies, for the implementation both of the IPoA and of the Sustainable Development Goals.

The Africa and Haiti group received the lion's share of FDI flows to LDCs (79.9 per cent of the total). Asian LDCs received 19.7 per cent of the total and the remaining 0.4 per cent went to the island LDCs.

…80 per cent of which went to the Africa and Haiti group.

At a country level, there was a remarkable growth in FDI inflows between 2014 and 2015 in Angola (+351.7 per cent), Myanmar (+198.4 per cent), Liberia (+85.1 per cent), Nepal (+73.8 per cent) and the Lao People's Democratic Republic (+69.2 per cent). This is in marked contrast to the situation between 2013 and 2014 when Angola, Liberia and Nepal experienced a contraction in FDI inflows. Other countries that experienced positive growth of FDI inflows between 2014 and 2015 after a significant contraction in the preceding year

include Bangladesh, Guinea, Guinea Bissau, Madagascar, Solomon Islands, Somalia and the Sudan. FDI inflows switched from being negative to positive in Chad and Vanuatu, and fell considerably in Burundi (-84.4 per cent), Kiribati (-78.9 per cent), the Gambia (-62.7 per cent), Bhutan (-61.8 per cent) and Burkina Faso (-53.1 per cent).

4. Personal remittances

Remittances to LDCs rose to $41.3 billion in 2015, 7.1 per cent of the world total…

Personal remittances[9] worldwide fell to $582 billion in 2015 from a historic high of $592 billion in 2014. Remittances to LDCs as a group moved in the opposite direction, rising from $38.5 billion in 2014 to $41.3 billion in 2015 (table Intro.5). While this amounts to just 7.1 per cent of the world total, remittances are a significant contributor of external finance in a number of LDCs (UNCTAD, 2012). In 2014, the share of remittances in GDP was 29.2 per cent in Nepal, 24.6 per cent in Liberia, 22.7 per cent in Haiti, 21.2 per cent in the Gambia and 20.2 per cent in the Comoros, and it exceeded 10 per cent in Lesotho, Senegal and Tuvalu. In 2015, the largest recipients of remittances as a share of GDP (among countries for which data were available) were Liberia (33.8 per cent), Nepal (33.4 per cent), Haiti (24.7 per cent), Senegal (11.7 per cent) and Kiribati (11.0 per cent). Of the 23 largest recipients of remittances as a share of GDP in the world (more than 10 per cent of GDP), five were LDCs. In terms of volume, the largest recipients of remittances among LDCs are Bangladesh ($15.4 billion in 2015), Nepal ($7 billion), Myanmar ($3.5 billion), Yemen ($3.5 billion), Haiti ($2.2 billion), Senegal ($1.6 billion) and Uganda ($1.1 billion). These seven countries accounted for 82.5 per cent of remittances flowing to LDCs in 2015, confirming the historical pattern of concentration of remittance inflows in a few LDCs. The ability of LDCs to muster increasing flows of remittances from their diasporas is likely to depend on a range of factors that include migration possibilities for their citizens abroad, maintenance of close affective ties between diasporas and their countries of origin, costs and facilities to transfer funds from host countries to countries of origin, and domestic conditions in countries of origin.

…and five of the 23 largest recipients relative to GDP are LDCs.

E. The economic outlook for least developed countries

The economic and social prospects of LDCs remain fragile and uncertain.

The economic outlook for LDCs as a group for the next two years remains uncertain and will be driven by unfolding conditions at the global level. The current international economic scenario remains lacklustre due to a combination of weak demand in developed countries as a result of stagnant real wages, the continuing slowdown of international trade, a sharp decline in growth or even recession in many developing countries, high or rising debt in both developed and developing countries, and depressed commodity prices (UNCTAD, 2016b). This international environment will continue to weigh down on the outlook for economic growth in LDCs and, hence, on their prospects for graduation and sustainable development. Nevertheless, the collective GDP growth of the LDCs

Table Intro.5. Remittances inflows to LDCs, 2002–2015, selected years
(Millions of current dollars)

Category	2002–2008	2010	2013	2014	2015
LDCs (total)	**13 446.6**	**25 330.8**	**35 374.4**	**38 523.0**	**41 323.8**
African LDCs and Haiti	5 412.5	8 555.5	10 129.3	10 337.5	11 004.5
Asian LDCs	7 964.4	16 499.8	25 003.4	27 924.5	30 036.2
Islands LDCs	69.7	275.6	241.8	261.0	283.1

Source: UNCTAD secretariat calculations, based on data from the World Bank Migration and Remittances database (accessed July 2016).

is forecast to strengthen somewhat to 4.5 per cent in 2016 and 5.7 per cent in 2017. However, even if this stronger growth materializes, it will be lower than the IPoA target. African LDCs will be significantly more impacted, especially if the downward trend in commodity prices and slump in demand for commodities continue unabated, as developed and developing markets struggle to cope with challenges of their own in revitalizing their economies.

While LDC growth may strengthen in 2016-2017, this depends on global economic conditions…

A number of LDCs are likely to face increasing current account deficits as a result of a general fall in export earnings, reflecting slower global demand growth. This may be compounded by a further appreciation of the dollar or depreciation of their local currencies, inflating their import expenditures. Such increases in current account deficits will intensify pressure on the external financing requirements of the countries concerned.

Combined with volatile and unpredictable aid flows, and lower remittances due to deteriorating economic conditions in host countries, the depressed level of export earnings may also trigger adverse fiscal shocks, particularly in those LDCs dependent on aid and primary commodities. LDCs could be confronted with a situation of "twin deficits" (that is, a combination of external and fiscal deficits), which would require sound macroeconomic policy management. Outbreaks of civil unrest in politically unstable LDCs and adverse environmental shocks, especially in small island LDCs, will only increase their economic vulnerabilities further. Such adverse external and internal shocks can be expected to impede national development strategies and planned infrastructure improvements in many LDCs.

…and macroeconomic management needs to address the risk of twin (external and fiscal) deficits.

Overall, the economic and social prospects of LDCs remain fragile. The accelerated implementation of development-oriented policies — to reduce economic vulnerabilities through the development of productive capacities, to promote social inclusion and cohesion, and to mitigate disaster-related risks — remains a paramount priority for all LDCs. This applies equally to those expected to graduate before 2025, and those for which graduation remains more distant, as analysed in the remainder of this Report.

Notes

1 A comprehensive set of statistics on the LDCs is available in *Statistical Tables on the Least Developed Countries – 2016* (available at unctad.org/LDCs/Statistics), a sister publication to the present Report.

2 The real GDP growth rate (per cent) for the LDC group as a whole was 6.6 per cent in 2008, 4.6 per cent in 2009, 5.6 per cent in 2010, 4.4 per cent in 2011, 7.1 per cent in 2012, 6.1 per cent in 2013, 5.6 per cent in 2014 and 3.6 per cent in 2015.

3 This analysis of the current account is based on data from the International Monetary Fund's (IMF) World Economic Outlook database of April 2016, which includes data for 2015 and projections for subsequent years. These data may differ from data contained in the UNCTADstat database. Data from UNCTADstat on 2015 current account balances were not yet available at the time of writing.

4 Whereas export sales of fish are classified as merchandise exports, revenues from royalties and licence fees for fishing by foreign fleets are recorded in the balance of payments as a services receipt.

5 This discussion is based on data from UNCTADstat database (accessed July 2016). Data for trade in services follow the methodology of the sixth edition of the IMF's balance of payments manual (IMF, 2009).

6 Data for 2015 were not available at the time of writing.

7 Official development financing consists of (a) bilateral ODA, (b) grants and concessional and non-concessional development lending by multilateral financial institutions, and (c) other official flows for development purposes (including refinancing loans) that have too low a grant element to qualify as ODA (source: Organization for Economic Cooperation and Development (OECD), OECD Statistics Database (http://stats.oecd.org/) (accessed September 2016)).

8 Excluding allocations that are not attributed to a specified recipient country.

9 The World Bank data on remittances used here include balance of payments data and estimates.

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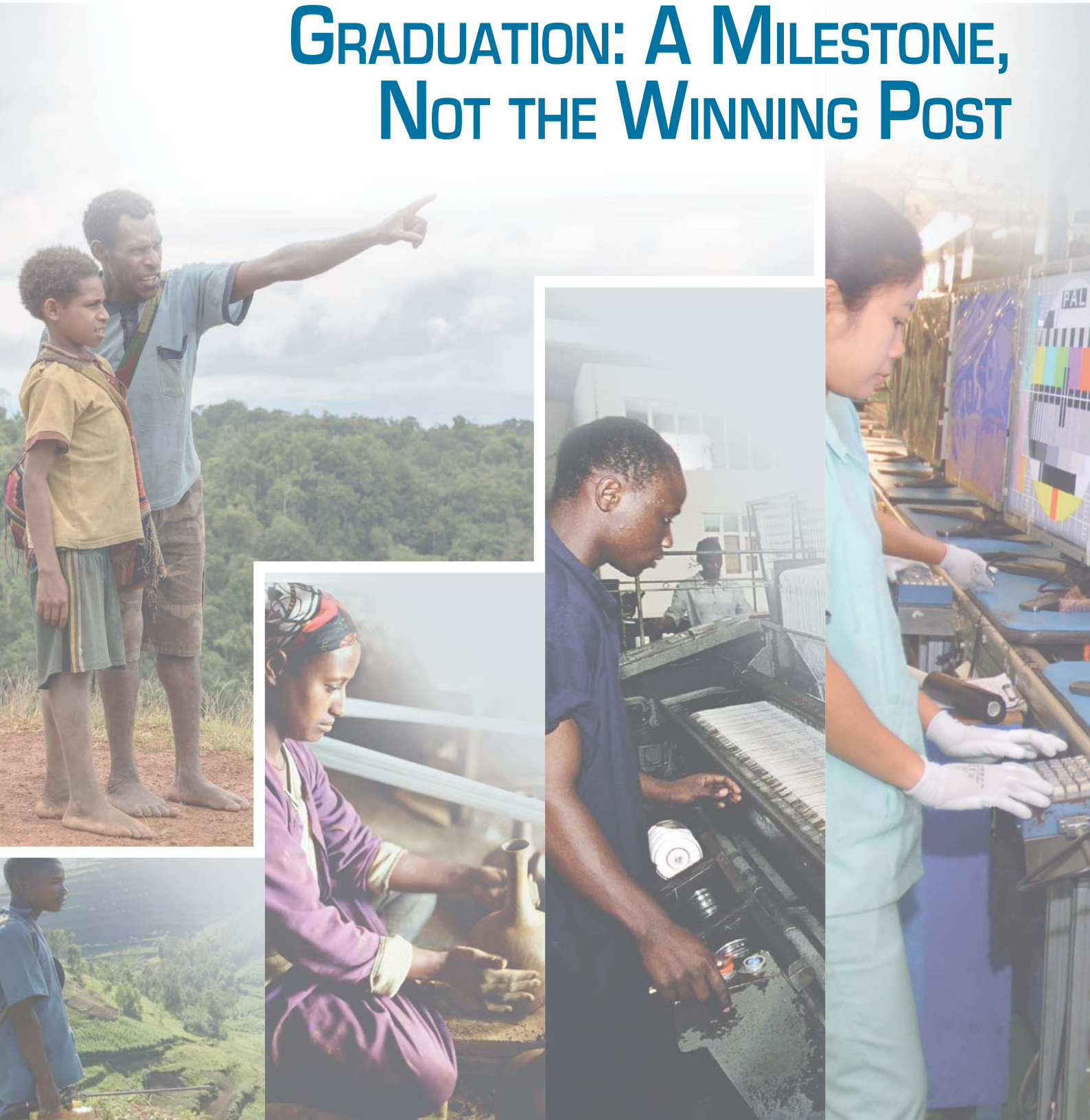
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CHAPTER 1

Graduation: A Milestone, Not the Winning Post



A. Introduction

While the 2030 Agenda for Sustainable Development (2030 Agenda) and the Sustainable Development Goals imply a much stronger focus on the least developed countries (LDCs) than did the Millennium Development Goals (UNCTAD, 2015a), they do not include an explicit goal for graduation from LDC status. However, such a goal was previously established by the Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the Istanbul Programme of Action (IPoA)), adopted in 2011. This included for the first time an explicit target for graduation — that at least half of the 49 countries classified as least developed at the time should satisfy the criteria for graduation from LDC status by 2020. Though not embodied in the 2030 Agenda, this represents a bold step by the international community to move LDC graduation towards the centre of international attention.

The IPoA set a target that half of all LDCs should satisfy the criteria for graduation by 2020.

At the halfway point between the adoption of the IPoA target and the target date of 2020, it is timely to review the nature and historical experiences of graduation, and the outlook for graduation to 2020 and beyond.[1] This is the focus of *The Least Developed Countries Report 2016*. It analyses the experience of LDC graduation since the establishment of the category in 1971, against the background of the major changes that have occurred in the global economic environment in this period; examines the outlook for graduation until 2024; and draws conclusions for national policies and international support measures (ISMs) for LDCs and the graduation process. The objective is to assist countries graduating in the future to achieve what this Report terms "graduation with momentum" — a development path leading to graduation that also establishes the basis needed for continued and solid sustainable development in the post-graduation phase.

This Report aims to help future graduates achieve "graduation with momentum".

The present chapter provides the historical context and conceptual framework for the remainder of the Report. Section B places graduation in the context of the origins and rationale of the LDC category and the underdevelopment "traps" that underlie it. This is followed by a presentation of the graduation process and criteria (section C), and the historical evolution of the LDC list as a result of new inclusions in, and graduations from, the category (section D). Section E highlights the greater-than-ever relevance of the LDC category, as a result of the economic and social divergence between LDCs and other developing countries (ODCs), reflecting the interaction between divergences in their productive capacities and long-term changes in the global economic environment. Section F presents graduation in the context of the longer-term process of development, emphasizing the importance of graduation with momentum. Finally, the economic and political calculus of graduation, from the perspective of LDC governments, is discussed in section G.

Following this chapter, the Report is structured around four further chapters. Chapter 2 presents projections for graduation cases in the 2017–2024 period and describes the national dynamics of graduation, including the role of geographical constraints, and the processes, strategies and policies leading to graduation. Chapter 3 examines the role and limitations of ISMs in bringing LDCs to graduation, including an assessment of their role in past graduation cases. Chapter 4 analyses the post-graduation phase of the development process, examining smooth transition, the costs and benefits of graduation, and the experience of those countries that have graduated to date. Chapter 5 discusses how graduation can be steered to achieve graduation with momentum, to avoid major post-graduation pitfalls and traps. It discusses policy alternatives for consideration by LDCs and by the international community to strengthen the development processes of LDCs and establish "graduation-plus" strategies for graduation with momentum.

B. The least developed country predicament, the rationale of the category and the significance of graduation

1. The rationale of the least developed country category

The nature and significance of the graduation process emerge from the rationale of the LDC category…

The nature and significance of the graduation process emerge from the rationale of the LDC category. From its inception, the rationale of a distinct category of LDCs was that certain developing countries had particularly low levels of economic and human development and limited economic and export diversification, in most cases associated with these countries' relatively recent emergence from colonial rule and/or geographical factors; and that this underdevelopment gave rise to insurmountable obstacles to their ability to engage with global markets or to derive developmental benefits from doing so. A brief history of the LDC category is presented in box 1.1.

Box 1.1. A brief history of the LDC category

The concept of the least developed countries has its origins in the first session of the United Nations Conference on Trade and Development (UNCTAD I), which adopted without dissent a recommendation that (United Nations, 1964, annex A.IV.1, paragraph 4, emphasis added)):

> Industrialized countries and regional and international organizations should endeavour to increase the flow of the technical assistance needed to accelerate the growth of developing countries, *and particularly of the least developed*, to achieve the maximum efficiency in the use of external resources.

It also adopted a general principle that (United Nations, 1964, general principle fifteen:11, emphasis added):

> The adoption of international policies and measures for the economic development of the developing countries shall take into account the individual characteristics and different stages of development of the developing countries, *special attention being paid to the less developed among them*, as an effective means of ensuring sustained growth with equitable opportunity for each developing country.

Both the concept of LDCs and the linkage with ISMs was reinforced by UNCTAD II in 1968, which adopted a resolution on "Special measures to be taken in favour of the least developed among the developing countries aimed at expanding their trade and improving their economic and social development". This called on the Secretary-General of UNCTAD to (United Nations, 1968, resolution 24 (II)):

> undertake studies of different aspects of the special problems of the least developed countries with a view to devising effective measures that would enable these countries to benefit fully from measures undertaken within the UNCTAD programme and framework.

While inviting other agencies "to identify such countries in the context of each measure concerned, taking fully into account the identifying criteria relevant to the policy measure in question" (resolution 24 (II), paragraph 2), it also requested the Secretary-General of UNCTAD "to continue studies relative to the identification of least developed countries" (paragraph 3(c)). This resolution thus provided the foundation both for the LDC category and later for *The Least Developed Countries Report* series, which UNCTAD started publishing in 1984.

On 13 December 1969, the United Nations General Assembly adopted the International Development Strategy for the Second United Nations Development Decade, including a section on the adoption of measures to support LDCs (resolution 2626(XXV):C.5). In early 1970, a working group of the United Nations Committee for Development Planning (later renamed the Committee for Development Policy (CDP)) was formed to identify the LDCs (box 1.2).

Further resolutions were passed on special measures in support of LDCs at UNCTAD III in 1972 and UNCTAD IV in 1976. However, a heightened sense of urgency was apparent at UNCTAD V in 1979, reflecting the adverse global economic environment for development at the time. In a resolution adopted without dissent, the Conference expressed concern that the UNCTAD III and IV resolutions had not been fully implemented, and also "deep concern at the gravity of the economic and social situation of the least developed countries". It therefore launched "as one of its major priorities" a Comprehensive New Programme of Action for the Least Developed Countries, encompassing an Immediate Action Programme for 1979–1981 and a Substantial New Programme of Action for the 1980s. This programme was finalized and adopted unanimously by the international community in 1981 at the First United Nations Conference on the Least Developed Countries, which was convened in Paris by the General Assembly to establish such a programme. This was followed by further such conferences in 1990 (also in Paris), 2001 (in Brussels) and 2011 (in Istanbul), each of which adopted a programme of action for the following decade. The most recent of these is the IPoA.

Sources: UNCTAD secretariat; CDP (2015); Guillaumont (2009).

Then as now, these obstacles were linked with the idea that LDCs are caught in an "underdevelopment trap" arising from a number of intersecting vicious circles, most notably the poverty trap and the commodity dependence (see, for example, Guillaumont, 2009; UNCTAD, 2002). The consequence is that the vulnerabilities associated with low levels of economic and human development and limited diversification of production and exports in LDCs hamper their ability to derive developmental benefits from engagement in international markets. This view, the conceptual roots of which can be traced to the seminal work of development economists such as Rosenstein-Rodan, Nurkse and Hirschmann, was and remains a key part of the rationale for the LDC category.

…particularly the idea that LDCs are caught in an underdevelopment "trap".

It should be emphasized that the terminology of "traps" does not mean that these problems are insurmountable or deterministic, although they may be exacerbated by geographical challenges (for example, landlocked position, extremely small size or remoteness). Rather, "traps" are vicious circles that need to be overcome if a country is to establish a sustainable development path (Sindzingre, 2012). Nonetheless, escaping from such traps requires specific and concrete actions.

LDC-specific ISMs are intended to enable LDCs to break out of this trap…

The international community therefore decided to establish ISMs, especially in the fields of finance, trade, technology and technical assistance, to assist "low-income countries which faced severe structural handicaps to economic growth and development and needed access to support beyond what was commonly available for all developing countries" (CDP, 2015). By providing more favourable treatment for LDCs than for ODCs, such measures were intended to help them to break out of the trap of underdevelopment, to overcome their major development challenges, and thus to embark on a path of sustainable growth and development.

…requiring clear criteria to define which countries are LDCs.

Establishing ISMs specific to LDCs required the establishment of a clearly defined category of LDCs, and thus a set of criteria as a basis for such a definition. A corollary of this, though not operationalized until two decades after the establishment of the LDC category in 1971, is the definition of a point at which a country has attained a sufficient level of development that it has escaped the traps associated with underdevelopment, and therefore no longer requires the special treatment associated with LDC status – that is, a point at which it should be considered to have graduated from LDC status.

Hence, it is in the context of these traps and vicious circles, the most important of which are outlined in the following subsections, that the significance and nature of graduation can best be understood.

2. The poverty trap

The poverty trap arises because low incomes and slow growth increase poverty, while poverty slows growth by limiting investment.

A poverty trap can be defined as "a circular constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty" (Nurkse, 1953:4). On the one hand, low incomes and slow economic growth are reflected in a persistently high incidence of poverty; on the other, pervasive poverty acts as a brake on investment, limiting economic growth (Azariadis and Stachurski, 2005). Where the majority of the population lives at income levels at or below those necessary to meet their basic needs, this all-pervasive poverty acts as a major constraint on economic growth (UNCTAD, 2002).

Collectively, LDCs are the group of countries where poverty is most pervasive. In 2011, all but seven LDCs had a poverty headcount ratio above 30 per cent, whereas in only five ODCs was it even above 25 per cent (UNCTAD, 2015a). Poverty reduction has also been much slower in LDCs than in ODCs, and fell

far short of the Millennium Development Goals target: in LDCs, the poverty headcount ratio fell by less than one third, from 65.7 per cent in 1990 to 44.8 per cent in 2011, compared with a fall from 47.7 per cent to 18.1 per cent in ODCs (United Nations, 2015). Thus almost half of the overall population of LDCs lives in poverty, with much higher rates in some individual LDCs – in excess of 70 per cent in 2011 in Burundi, the Democratic Republic of the Congo, Liberia, Madagascar, Malawi and Zambia.[2]

Poverty is systematically higher, and falling more slowly, in LDCs than in other developing countries...

A major mechanism through which poverty hampers growth and development is its negative effects on the domestic resources available to finance investment and the provision of public goods. Where the majority of the population lives in absolute poverty, a major part of the gross domestic product (GDP) must be devoted to the necessities of life, giving rise to low savings and very limited capital accumulation. This in turn leads to low fixed investment, and thus to low productivity and low incomes.

Similarly, State capacities tend to be weaker where extreme poverty is pervasive. This situation gives rise to a very narrow fiscal base, which limits the provision of public services such as education, health, administration, and law and order. While government revenues, public investment and government final consumption expenditure in LDCs may appear little lower than in ODCs in terms of GDP share, this translates into extremely limited resources in absolute per-capita terms (UNCTAD, 2002).

…undermining domestic resource mobilization and State capacities.

An important aspect of poverty traps in LDCs is the fact that a large majority (two thirds) of the LDC labour force works in agriculture, especially smallholder agriculture, which suffers from chronically low and slow-growing labour productivity. This is, in itself, a major cause of poverty, and thus tends to be self-perpetuating: the high levels of risk aversion inherent in extreme poverty interact with the extreme uncertainties of agricultural yields, output and income that are characteristic of traditional smallholder agriculture; and this limits the adoption of new technologies and techniques that could raise labour productivity and household incomes (UNCTAD, 2015a).[3]

Poverty traps are particularly pervasive in agriculture, which employs two thirds of the workforce in LDCs.

There are thus various vicious circles — processes of circular and cumulative causation — in which the high incidence and severity of poverty act as constraints on economic growth, which in turn perpetuates all-pervasive poverty.[4] A similar phenomenon arises from the detrimental effect of poverty on the environment: widespread and serious poverty may lead to environmental degradation, undermining sustainability, as people have to overexploit natural capital to make an adequate living, even if this ultimately reduces the productivity of key assets on which their livelihoods depend (Barrett et al., 2011). Over time, such environmental degradation also increases the uncertainty of agricultural production, further impeding technological upgrading.

Poverty tends to lead to unsustainable exploitation of natural capital.

3. The commodity-dependence trap

The international aspect of the poverty trap is particularly apparent in those countries that are heavily dependent on primary commodities. A complex set of interrelated trade and financial relationships may lock a country in to a disadvantageous pattern of market integration, exposing it to boom-and-bust cycles that ultimately compound its structural vulnerabilities and exacerbate poverty. While the coexistence of globalization with chronic poverty clearly does not indicate a causal relationship, it does mean that economic outcomes are increasingly determined by global economic forces, and not solely related to household, local and national factors (UNCTAD, 2002).

Trade and financial relationships may lock a country into commodity dependence.

Since the majority of LDCs, notably in the African region, depend heavily on primary commodities for the generation of employment, income, and

foreign exchange, a natural starting point for successful graduation strategies is the upgrading of the commodity sector. Key objectives in this respect are to improve productivity and to increase domestic value addition by fostering backward and forward linkages in key segments of the value chain, as a means of promoting commodity-based industrialization (UNECA and AUC, 2013; Morris and Fessehaie, 2014). This requires countries to overcome an array of challenges related to insertion into commodity value chains and upgrading within them. These include volatile and unstable international prices, intense competition among suppliers of raw materials, and barriers to skill development and adoption of more sophisticated technologies. Other challenges, particularly those related to resource management and utilization, are commodity specific, including, for example, the adoption of sustainable production practices and reduction of post-crop losses in agriculture.

In 38 LDCs commodities accounted for more than two thirds of merchandise exports in 2013–2015.

Most LDCs are characterized by a high level of reliance on primary commodities, particularly for export revenues, but also as essential sources of employment (in the case of agricultural commodities), income and government revenues. Abundant natural endowments of mineral and fuel stocks or agricultural land (compounded in many cases by legacies from the colonial era) have shaped LDCs' comparative advantages and specialization strongly towards primary commodity sectors. In the overwhelming majority of LDCs (38 of the 47 for which data are available), commodities accounted for more than two thirds of merchandise exports in 2013–2015.

Commodity dependence is driven mainly by agricultural produce in nearly half of LDCs, and by minerals and fuels in many African LDCs.

In nearly half of the LDCs, the disproportionate weight of primary commodities in the export basket is mainly driven by food items, particularly tropical beverages and fish, and agricultural raw materials such as cotton. Exports of minerals, and particularly metals, play a key role for the African LDCs that make up the mineral exporters group in the classification used in this Report (the Democratic Republic of the Congo, Guinea, Mali, Mauritania, Rwanda, Sierra Leone and Zambia), while fuels account for the great majority of merchandise export revenues for the fuel exporters group (Angola, Chad, Equatorial Guinea and Yemen)[5] (figure 1.1).

Commodity dependence can lock countries into a development path based on static comparative advantage.

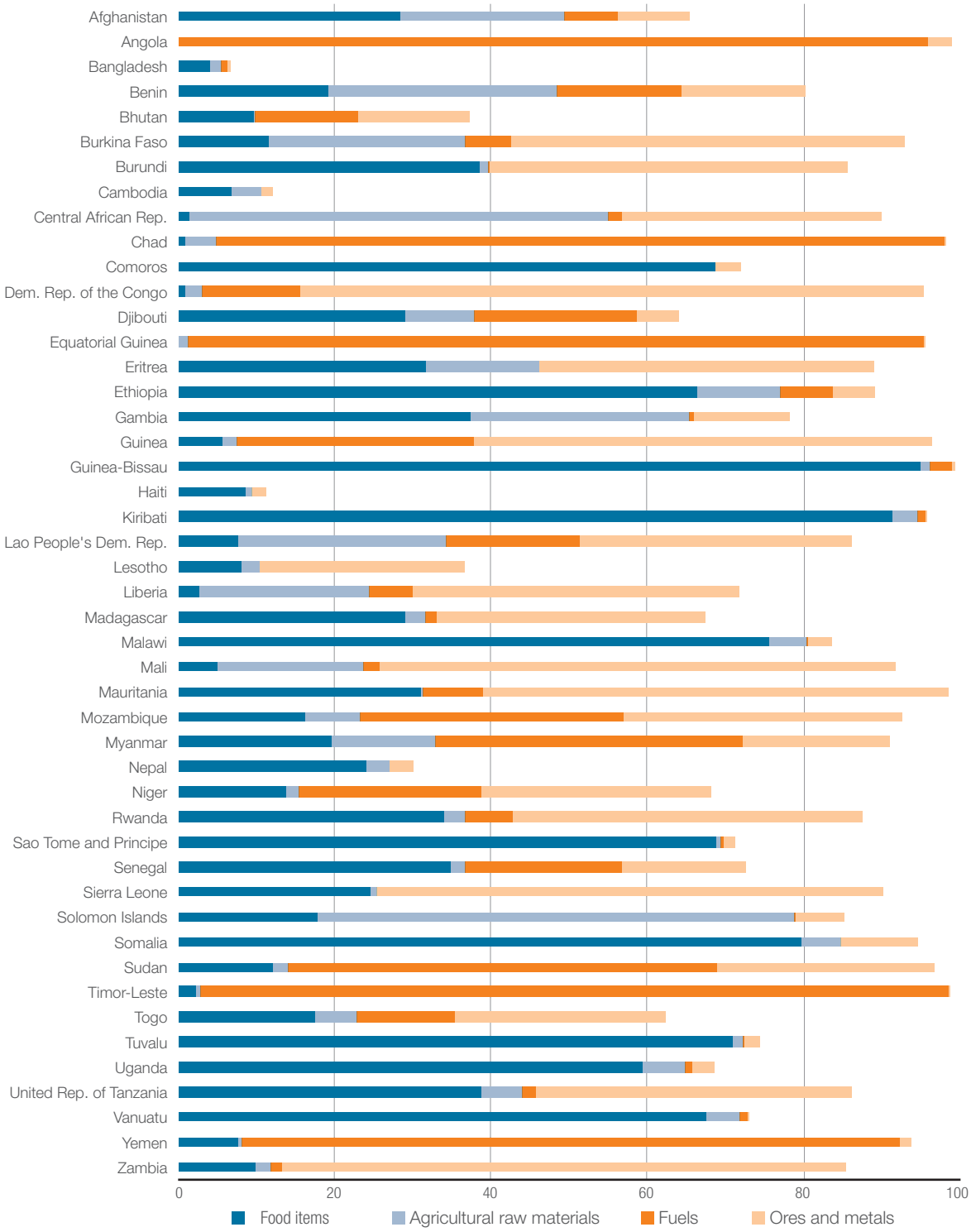
Commodity dependence inhibits the emergence and development of activities in other sectors, thus restricting economic and export diversification. It can thus lock countries into a development path based on static comparative advantage rather than the dynamic evolution of comparative advantage in progressively more sophisticated and development-oriented activities.

Only a handful of LDCs have reduced their commodity dependence significantly since 2000, while it has increased in around a quarter.

The changes in the commodity shares in LDC exports clearly demonstrate the persistence of commodity export dependence (figure 1.2). As the figure shows, only a handful of LDCs (Afghanistan, Burundi, the Comoros, Solomon Islands and Uganda) have experienced any significant reduction in their dependence on primary commodities since the beginning of the century, while around a quarter have seen increases of a similar magnitude. More generally, despite many instances of growth accelerations partly or wholly underpinned by commodity sectors, relatively few commodity-dependent developing countries have managed to achieve sustainable development gains through successful economic diversification.

Concerns about the persistence of commodity dependence have often been linked with other factors such as a supposed secular decline of commodity prices (generally referred to as the Prebisch-Singer hypothesis), exposure to commodity price volatility and the absence in the commodity sectors of the opportunities for increasing returns and learning-by-doing characteristic of the manufacturing sector. Previous UNCTAD publications have argued that the current international trade and financial architecture reinforces commodity-related boom-and-bust cycles, by limiting the policy space available to commodity-dependent countries to take measures to increase the sophistication of their economies by increasing value addition to locally sourced commodities (UNCTAD, 2013a, 2014a).

Figure 1.1. Primary commodities as share of merchandise exports, by commodity group, 2013–2015



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

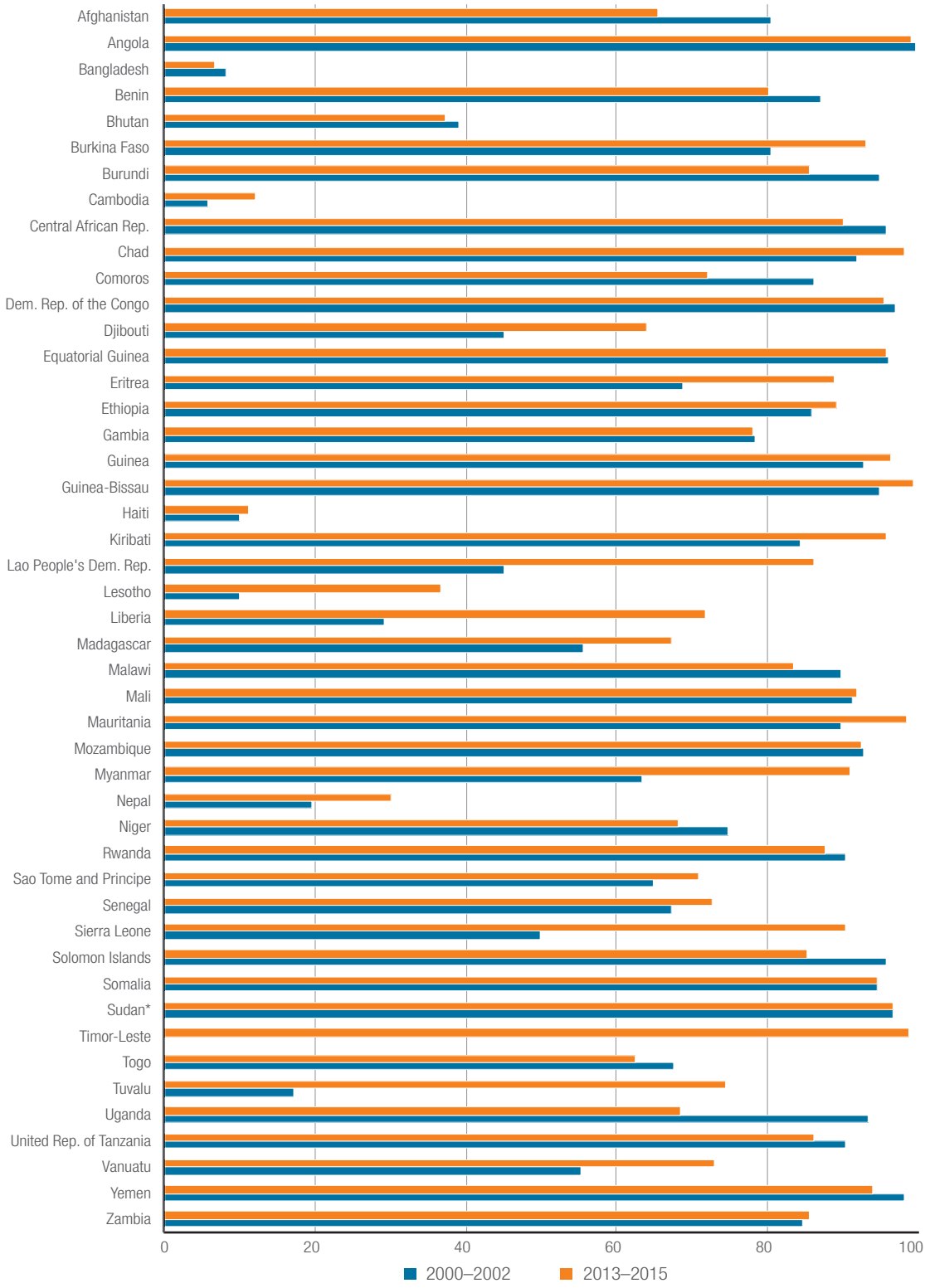
As discussed below, the economic challenges arising from commodity dependence can hamper development and thus cast a shadow on LDCs' graduation prospects.

Commodity dependence worsens LDCs' vulnerability to exogenous shocks…

(a) External vulnerability

Commodity dependence worsens developing countries' vulnerability to exogenous shocks (for example, extreme meteorological events, negative effects of climate change and adverse terms-of-trade movements), which can

Figure 1.2. Primary commodities as share of merchandise exports in LDCs



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

…as shown by the 2008-2009 financial crisis and the subsequent slump in commodity prices.

have serious and wide-ranging macroeconomic impacts. Terms-of-trade shocks are of particular relevance, as dependence on primary commodity exports tends to be associated with a high level of export concentration, particularly among LDCs (figure 1.3). Since commodity price changes are essentially exogenous to most LDCs, whose capacity to withstand large commodity shocks is very limited, these countries bear a disproportionate share of the adjustment costs of commodity market volatility.

The risks associated with commodity market volatility have been highlighted both by the 2008–2009 crisis and by the more recent (and ongoing) slump in commodity prices. Contrary to the implication of the "efficient market hypothesis", there is little evidence that commodity financialization has reduced price volatility. Rather, it has introduced spurious price signals, reflecting trading decisions based largely on financial market movements rather than on market fundamentals for each commodity (UNCTAD, 2015b; UNCTAD and Arbeiterkammer Wien, 2011). The greater correlation between commodity and other financial markets increases the difficulty of coping with often procyclical price movements, whose macroeconomic effects can be substantial (UNCTAD, 2013a).

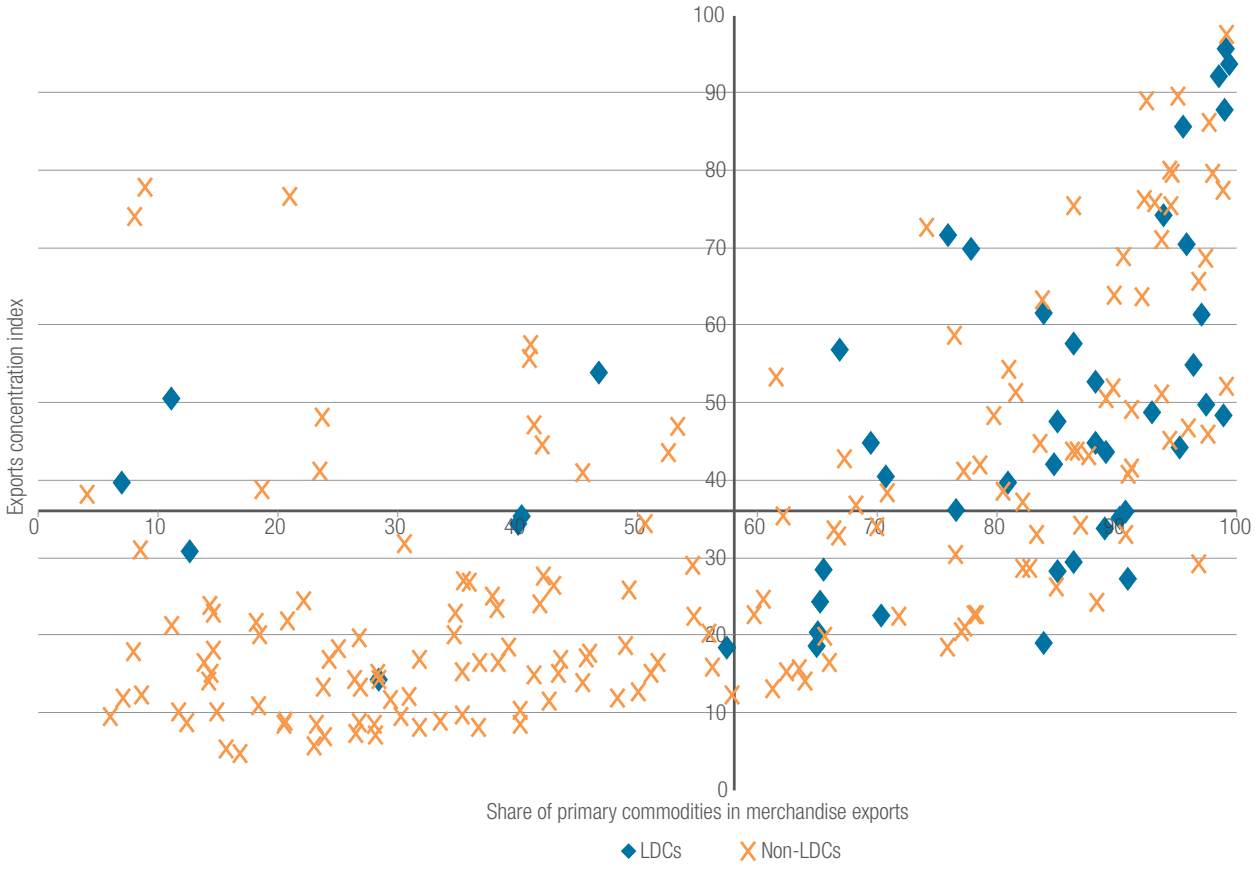
Adverse price movements even in a few key commodity markets can put pressure on the balance of payments.

While rising commodity prices undoubtedly underpinned growth in LDC export revenues for most of the 2000s, especially among African LDCs, much of this expansion stemmed from an increase in prices rather than in export volumes. Export volume growth has been increasingly outpaced by that of imports, further increasing exposure to adverse terms-of-trade shocks. In a context of chronic current account deficits in the majority of LDCs (with the notable exception of fuel exporters in some years), adverse price movements even in a few key commodity markets have the potential to trigger significant terms-of-trade shocks, putting pressure on the balance of payments (subsection 4).

LDCs are also exposed as importers to price volatility in commodity markets for food and fuel.

It should also be noted that LDCs' dependence on imports of food and fuel exposes them to price volatility in commodity markets for these goods as importers, in addition to their exposure to the markets for their major products as exporters. Since imports of food and fuel are both difficult to compress in the short term, and highly vulnerable to sharp fluctuations in international prices, this high level of import dependence reinforces the external vulnerability arising from

Figure 1.3. Primary commodity dependence and export concentration, 2012–2014



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

commodity dependence. This tendency has recently been demonstrated by the experiences of net fuel importing LDCs in the 2003–2011 period and of net food importers in 2008–2011.

(b) Global value chains

The emergence of global value chains raises the risk of locking in LDCs' commodity dependence…

The emergence of global value chains (GVCs) has the potential to create a more efficient international division of labour and open new opportunities of economic diversification. However, it also raises the risk of locking in LDCs' commodity dependence through specialization in primary commodities and low-value-added products, thereby hampering the gradual upgrading of the sophistication of production and exports that lies at the core of successful development trajectories (Hausmann et al., 2007).

...as upgrading along GVCs depends on a number of country-specific factors.

In principle, connecting to GVCs, even though the production of raw material or of simple apparel (as in the case of Lesotho, Haiti and various Asian LDCs) can provide firms with opportunities to accumulate technological capabilities, acquire tacit knowledge and establish business relationships, thus paving the way for subsequent upgrading (UNCTAD, 2013c). However, the process of upgrading along a GVC is far from automatic, and depends on a number of factors, including the input-output structure, geographic features and governance of the supply chain, and the interaction of these factors with the socioeconomic and institutional context of the host country (Gereffi et al, 2005; UNCTAD, 2013a; UNECA, 2015a). In the case of the apparel sector in Lesotho and Madagascar, for example, more locally-embedded regional or diaspora-owned firms tend to provide greater upgrading prospects than other lead firms, whose primary interest is in exploiting preferential access to the United States market under the Africa Growth and Opportunity Act (Staritz and Morris, 2013).

The scope for upgrading within a GVC can be enhanced through supportive institutions.

While captive value chains (those characterized by asymmetric bargaining power between the lead firm and its suppliers) typically offer less potential for upgrading, the scope for sophistication may be enhanced by the presence of a supportive institutional framework and innovation system (Pietrobelli and Rabellotti, 2011). Examples include Botswana's diamond industry, where the Government has played a significant role in fostering linkages to downstream activities, through the establishment of the international branch of the Diamond Trading Company and the promotion of training programmes on gem-cutting and polishing (UNECA, 2015a).

Fuel and mineral commodity value chains tend to be capital-intensive, and LDCs are mostly confined to low-end activities.

Fuel and mineral commodity value chains tend to be capital-intensive, and moving beyond basic transformation requires specific engineering and/or chemical skills and reliable energy supply, factors which are typically lacking in LDCs. Even in sectors where they display revealed comparative advantage, LDCs are thus mostly confined to low-end activities and to the role of exporters of raw materials (UNCTAD, 2007: chap.1). This suggests that the emergence of GVCs and the associated reorganization of the production process have in most cases left LDCs' commodity dependence virtually unchanged. While both trade in intermediate goods and trade in value-added terms suggest that the majority of LDCs have established small but rapidly expanding forward linkages within global supply chains (UNECA, 2015a), these relationships are often restricted to the supply of products embodying limited domestic value addition.

Similar problems arise in LDC agricultural sectors, which are typically dominated by smallholder farmers, as the benefits to small producers of connecting to agricultural GVCs are likely to be limited by the concentration of market power that characterizes them. For example, four transnational corporations control more than 60 per cent of the global coffee market, while three control 85 per cent of the world's tea market. This poses significant challenges to small producers at the early stages of buyer-driven value chains controlled by global retailers and category buyers (UNCTAD, 2013a).

(c) The natural resource curse

The benefits to small producers of connecting to agricultural GVCs are limited by concentration of market power.

Commodity dependence, and dependence on mineral and fuel exports more particularly, has often been associated with sluggish growth and poor economic and social performance, a phenomenon often referred to as the "natural resource curse" (Frankel, 2010; Gylfason, 2001; Sachs and Warner, 1995). In addition to "Dutch disease" (associated with exchange rate appreciation triggered by surging commodity export revenues undermining the competitiveness of manufacturing), concerns revolve primarily around the limited use of the resources generated by extractive industries due to weak incentives for savings and investment (including in human capital) and obstacles to harnessing resource rents for development. Resource rents originating in extractive industries are unequally distributed, partly reflecting a "race to the bottom" to attract resource-seeking foreign direct investment (FDI) through lower taxation and royalties and weaker regulation. Combined with the limited reinvestment in the local economy of profits from extractive industries, which have in practice mostly been remitted, this has constrained LDCs' ability to leverage primary commodities for structural transformation (UNCTAD, 2010, 2013a).

Commodity dependence is also associated with the "natural resource curse".

Illicit financial flows through trade mis-invoicing are a particularly important dimension of the resource mobilization issue, in light of their documented magnitude, making this a high policy priority for commodity-dependent LDCs, most notably in the fuel, mining and timber sectors (Mevel et al., 2013; UNCTAD, 2016a; UNDP, 2011; UNECA, 2015b). A recent study by UNCTAD, for example, documents significant under-invoicing of Zambian copper exports to most trading partners (UNCTAD 2016b).

Illicit financial flows through trade mis-invoicing are a key deterrent to resource mobilization.

Limited resources and weak incentives for investment represent a particular obstacle to reducing commodity dependence, because investment and human capital are essential to the development of new sectors and activities, and particularly to increasing the sophistication of production. This is compounded by the Dutch-disease effect, which reduces the incentives for investment in tradeable sectors in particular. Economic diversification is further inhibited by the inability of commodity-dependent LDCs to move beyond low-end activities or to foster the establishment of backward and forward linkages with the domestic economy. This reinforces the enclave nature of extractive industries in many LDCs, limiting opportunities for value addition and job creation.

The Dutch-disease effect weakens incentives for investment in tradable sectors.

Thus, while extractive industries have undoubtedly contributed to improving the macroeconomic fundamentals of many LDCs, their long-term developmental benefits depend crucially on the economic and institutional framework. Although mineral and fuel exports contribute substantially to generating government revenues and foreign-exchange earnings, their expansion has made little contribution to poverty reduction, even during boom phases (UNCTAD, 2013a).

4. Balance-of-payments constraints to growth

Despite macroeconomic benefits, extractive industries have contributed little to poverty reduction.

LDCs' generally very narrow export bases, exposure to variations in international commodity prices and heavy dependence on imports of essential goods results in a strong tendency towards chronic current accounts deficits. This has been compounded by a strong tendency for their trade opening to be accompanied by a trend towards stronger growth of imports than of exports, except for commodity exporters in periods of booming prices. When non-debt-creating financial flows such as official development assistance (ODA) and FDI are limited, this gives rise to accumulation of foreign debt; and overindebtedness limits access to countercyclical financing to offset external shocks, as well as potentially triggering highly damaging debt crises, such as those experienced by many African LDCs in particular throughout the 1980s and 1990s (UNCTAD, 2016a).

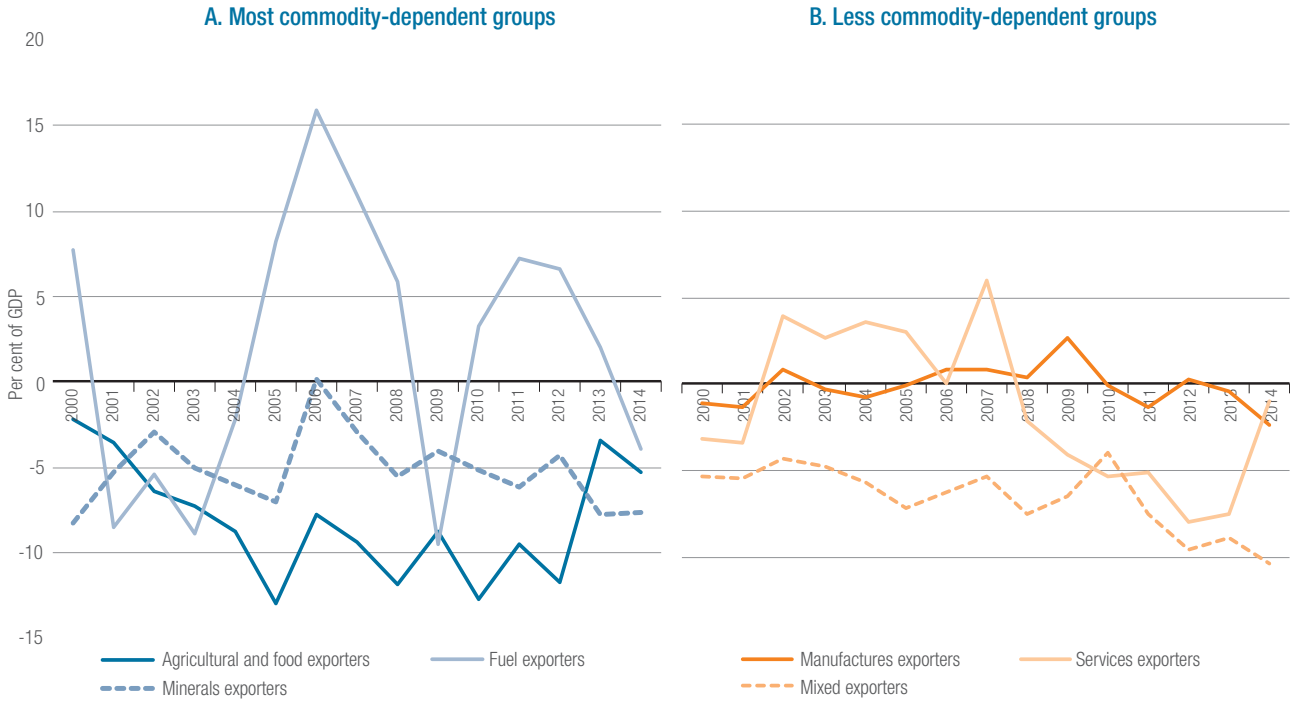
The current account balances of LDCs since 2000 are shown in figure 1.4, by export categories. This highlights particularly the very wide swings in the current account balances of fuel exporting countries. Mineral and agricultural exporters also show wide variations, with persistent and often large deficits; and mixed exporters also show consistently large deficits. While the current account of manufactures exporters is broadly in balance over time, with much more limited variations, services exporters moved from significant surpluses before the financial crisis to substantial deficits in the post-crisis period.

Large current account deficits result partly from heavy dependence on imports of food, fuels and capital goods…

Large current account deficits arise in part from the heavy dependence of most LDCs on imports of food, fuels and capital goods. Imports of capital goods (as well as intermediate goods and specialist services) are essential to the investment needed for the development or productive capacities, not least as a means of accessing new technologies needed to upgrade production and increase productivity. Equally, however, food and fuel imports are difficult to reduce at times of external shocks. This can give rise to a tension between the two: either food and fuel imports are maintained at the expense of capital goods, limiting investment and slowing growth and the development of productive capacities; or imports of capital goods are maintained (for example, due to binding commitments to investors), intensifying pressure on imports of food and fuels, with potential impacts on the well-being of the population. More generally, foreign-exchange shortage or exchange rate depreciation as a result of external shocks reduces the attractiveness of investments that use imported items, which are more likely to embody productivity-enhancing technologies.

The balance of payments is thus typically a constraint to LDCs' long-term economic growth and development (Thirlwall, 1979) and, hence, to graduation. Chronic current account deficits typically dampen investment and growth prospects, as they often end with a sharp balance of payments adjustment occasioned by tightening external financing constraints (Cavallo et al., 2016).

Figure 1.4. Current account balance of LDCs, by export category, 2000–2014



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).
Note: For the composition of the groups, see p.xiii.

Since the severity of these constraints depends on the composition of imports (in the short term) and of production and exports (in the longer term), economic diversification is a key element in overcoming them.

The period since the global financial and economic crisis has seen renewed recourse by LDCs to balance-of-payments support from the International Monetary Fund (IMF). Since 2010, IMF facilities have been used by 29 LDCs, of which 14 were using the Extended Credit Facility and two the Standby Credit Facility in September 2016.[6] While increases in foreign-exchange reserves in most LDCs over the last decade may contribute to easing their foreign-exchange constraints, reserve accumulation entails a considerable opportunity cost in terms of forgone mobilization of finance for developmental purposes.

…and give rise to balance-of-payments constraints to long-term development and graduation.

5. The significance of graduation

The above discussion provides a basis for an interpretation of the significance of graduation in the context of the LDC predicament and the rationale for the LDC category. In principle, graduation marks the point at which an LDC has escaped sufficiently from the vicious circles described above to enable it to operate in, and benefit from, international markets on an equal footing with ODCs — that is, to make a transition from reliance primarily on exceptional international support to a greater degree of reliance on international markets.

In principle, graduation marks the point at which an LDC has escaped from the vicious circles of underdevelopment.

As discussed in section F, however, policy approaches to graduation also need to go beyond the need to escape from the traps particular to the earliest stages of development, and take fully into account the need to prepare for the challenges of development beyond graduation. In other words, it is not sufficient merely to fulfil the criteria and complete the processes of graduation itself. The aim should rather be to achieve graduation with the momentum required to maintain development progress in the post-graduation period.

C. The graduation process and criteria

The concept of graduation was established only in 1991. Until that point, the criteria for LDC status had only been considered in relation to the addition of new countries to the list. Since then, the CDP has conducted triennial reviews, as part of which it analyses each LDC's performance against the graduation criteria and decides whether it is statistically eligible for graduation.

While the criteria for addition to, and graduation from, the LDC category have changed significantly over time (box 1.2), they are now based on three elements:

Graduation is based on three criteria: GNI per capita, a human assets index and an economic vulnerability index.

- The income criterion — gross national income (GNI) per capita;
- A human assets index (HAI);
- An economic vulnerability index (EVI).

The components of the HAI and EVI are shown in box figure 1.1.

An LDC may be considered to be statistically qualified for graduation if it achieves the threshold levels of two of these three indicators, or (since 2006) if its GNI per capita is at least double the threshold level. The latter is referred to as income-only graduation, and was introduced in response to rapid growth in certain LDCs — notably some oil-producing countries — which continued to perform poorly on the other graduation criteria.

Box 1.2. Evolution of the criteria for inclusion in, and graduation from, the LDC category

In 1971, in the interests of simplicity and clarity, the CDP established three criteria for a country's classification as an LDC:

- GDP per capita of $100 or less;
- An adult literacy rate (among those above 15 years of age) of 20 per cent or less;
- A share of manufacturing value added in GDP of 10 per cent or less.

Eligibility was based on countries meeting these three criteria. However, recognizing the need for flexibility in applying these criteria, the CDP allowed a slightly higher GDP per capita threshold (of $120) for countries that met the literacy and manufacturing criteria. In borderline cases, it also took account of recent growth rates and particular factors likely to affect the relevant indicators. In 1971, the CDP identified 25 countries as LDCs on this basis. The criteria were adopted by the United Nations General Assembly following reviews by the Economic and Social Council and an UNCTAD committee established for the purpose. The CDP was accorded the role of recommending revisions both to the criteria and the list of LDCs.

These criteria have been modified repeatedly over time (box figure 1.1). From 1975, the CDP decided that the threshold for GDP per capita should be adjusted, not only for global inflation (which was particularly high at the time), but also for global growth. The threshold was adjusted in this way in 1975, 1985 and 1990. In 1980, observing that adult literacy rates in several LDCs had increased above the threshold level while their economies remained undiversified and poverty remained acute, the CDP adopted a hierarchy of criteria, with GDP per capita at the top and literacy rates at the bottom. They thus allowed a country to be classified as an LDC if it met the GDP per capita and manufacturing-value-added criteria even if its literacy rate was above the threshold level.

The first substantial revision of the criteria came in 1991, when the adult literacy rate was replaced by the augmented physical quality of life (APQL), a broader composite indicator of human development; and the share of manufacturing in GDP was similarly replaced by a broader economic diversification index (EDI). The APQL retained the adult literacy rate, but combined this with indicators of health (life expectancy at birth), nutrition (per-capita calorie supply) and education (the combined primary and secondary school enrolment ratio). The EDI, likewise, included the share of manufacturing in GDP, but combined this with the export concentration ratio, the share of employment in industry and per-capita electricity consumption.

An additional criterion for inclusion was also added in 1991, although this was not considered in the context of graduation – that the population should be less than 75 million. This allowed Bangladesh to retain its LDC status, but would have prevented countries such as Nigeria or Pakistan from joining the list.

In 1991, the gap between the inclusion and graduation thresholds was fixed in absolute terms for each criterion ($100 in the case of GDP per capita). In its 1991 review, the CDP also emphasized the importance of flexibility in application of the graduation criteria, and the need to take account of other considerations such as natural resources, natural disaster risks and dependency on ODA in borderline cases. This was taken a step further in 1999, when the CDP decided that consideration of the inclusion and graduation criteria should be supplemented by a qualitative assessment of vulnerability. In the three years following the review in which the criteria were met, in the case of potential inclusion cases, UN/DESA was to prepare an assessment note on eligibility; and, in the case of potential graduation cases, UNCTAD was to produce a vulnerability profile, to be supplemented by ex-ante assessments of the likely consequences of graduation and potential gains and risks following graduation.

In 1999, the EDI was replaced with the EVI. While retaining export concentration, this changed the manufacturing value-added indicator to the share of manufacturing and modern services in GDP. Reflecting the shift of emphasis from diversification to vulnerability, the share of employment in industry and per-capita electricity consumption were dropped; and the logarithm of population (reflecting the greater vulnerability of very small economies) was added, together with indicators of the instability of agricultural production and of exports of goods and services (as indicators of vulnerability to climatic shocks and external economic shocks, respectively). More minor changes were also made to the health and nutrition components of the AQPL: life expectancy at birth was replaced by the under-5 mortality rate; and per-capita calorie supply was replaced with average calorie intake as a percentage of calorie requirements.

Two further minor changes occurred in 2002, when GDP per capita – unchanged as a criterion since 1971 – was replaced with GNI per capita, and the AQPL was further modified (replacing the combined primary and secondary enrolment ratio with the gross secondary school enrolment ratio) and renamed the human assets index (HAI).

In 1999, the gap between the inclusion and graduation criteria was changed to a fixed percentage (15 per cent, compared with 11–17 per cent for the previous absolute differences). In 2002, the margin between inclusion and graduation thresholds for GNI per capita was increased from 15 per cent to 20 per cent, while those for the HAI and EVI were reduced from 15 per cent to 10 per cent.

In 2005, average calorie intake per capita as a percentage of calorie requirements was replaced as a component of the HAI by the percentage of the population who are undernourished.

The EVI has also been further modified twice, in 2005 and 2011. In 2005, two further indicators were added – remoteness and homelessness due to natural disasters — and the share of manufacturing and modern services in GDP as a positive indicator was replaced with the share of agriculture, forestry and fisheries in GDP as a negative indicator. In 2011, homelessness due to natural disasters was replaced by a wider measure of victims of natural disasters; and the share of population in low-lying coastal areas was added, to reflect the potential risk of rising sea levels and storm surges as a result of climate change.

Sources: CDP (2015); Guillaumont (2009).

Box 1.2 (contd.)

Box figure 1.1. Changes in LDC criteria over time

2011 LDCs are low-income countries suffering from the most severe structural impediments to sustainable development

GNI per capita	Human Assets Index (HAI)	Economic Vulnerability Index (EVI)
	• Percentage of population undernourished (1/4) • Under-five mortality rate (1/4)	• Population size (1/8) • Remoteness (1/8) • Merchandise export concentration (1/16) • Share of agriculture, forestry and fisheries in GDP (1/16) • **Share of population in low-lying coastal zones** (1/8)
	• Gross secondary school enrolment ratio (1/4) • Adult literacy rate (1/4)	
		• **Victims of natural disasters** (1/8) • Instability of agricultural production (1/8) • Instability of exports of goods and services (1/4)

2005 LDCs are low-income countries suffering from low levels of human resources and a high degree of economic vulnerability

GNI per capita	Human Assets Index (HAI)	Economic Vulnerability Index (EVI)
	• **Percentage of population undernourished** • Under-five mortality rate	• Population size • **Remoteness** • Merchandise export concentration • **Share of agriculture, forestry and fisheries in GDP**
	• Gross secondary school enrolment ratio • Adult literacy rate	
		• **Homelessness due to natural disasters** • Instability of agricultural production • Instability of exports of goods and services

2002 LDCs are low-income countries suffering from low levels of human resources and a high degree of economic vulnerability

GNI per capita	Human Assets Index (HAI)	Economic Vulnerability Index (EVI)
	• Average calorie intake per capita as a percentage of the calorie requirement • Under-five mortality rate	• Population size • Export concentration • Share of manufacturing and modern services in GDP
	• **Gross secondary school enrolment ratio** • Adult literacy rate	• Instability of agricultural production • Instability of exports of goods and services

1999 LDCs are low-income countries suffering from low levels of human resources and a high degree of economic vulnerability

GDP per capita	Augmented Physical Quality of Life Index (APQLI)	Economic Vulnerability Index (EVI)
	• **Average calorie intake per capita as a percentage of the calorie requirement** • **Under-five mortality rate**	• **Population size** • Export concentration • **Share of manufacturing and modern services in GDP**
	• Combined primary and secondary school enrolment ratio • Adult literacy rate	• **Instability of agricultural production** • **Instability of exports of goods and services**

1991 LDCs are low-income countries suffering from long-term handicaps to growth, in particular, low levels of human resource development and/or severe structural weaknesses

GDP per capita	Augmented Physical Quality of Life Index (APQLI)	Economic Diversification Index (EVI)
	• **Per capita calorie supply** • **Life expectancy at birth**	• **Export concentration ratio** • Share of manufacturing in GDP • **Share of employment in industry** • **Per capita electricity consumption**
	• **Combined primary and secondary school enrolment ratio** • Adult literacy rate	

1971 LDCs are countries with very low levels of per capita gross domestic product facing the most severe obstacles to development

GDP per capita	• **Adult literacy rate**	• **Share of manufacturing in GDP**

Source: UNCTAD secretariat, based on CDP and UNDESA (2015).
Notes: **Bold** type indicates new components or new names.
For the 2011 criteria, numbers in parenthesis indicate the weighting in the index composition.

To qualify for graduation, a country must meet these conditions in at least two consecutive triennial reviews. As a further measure to limit the risk of premature graduation, resulting in a graduating country subsequently reverting to LDC status, the threshold levels of the indicators for graduation are set above those for inclusion in the category.

LDCs can graduate either by meeting two of the three criteria, or by reaching double the graduation threshold for GNI per capita.

Where a country meets these conditions for graduation, the CDP can make a recommendation for graduation for consideration by the Economic and Social Council. However, such a recommendation does not follow automatically from fulfilling the statistical graduation criteria — the specific circumstances of each country, particularly its vulnerability, are also taken into account, as is the anticipated impact of graduation and the loss of LDC treatment.

If the Economic and Social Council endorses the recommendation — again taking account of country circumstances and the likely impact of graduation — it sends the case to the United Nations General Assembly to take the final decision on the country's graduation, including its timing. While graduation should in principle take place three years after the decision to graduate the country is taken, a different grace period may be agreed. Longer periods have been agreed in nearly all graduation cases, but not as yet a shorter one.

Country-specific circumstances are also taken into account in graduation decisions.

Given the potential adverse effects of loss of access to LDC-specific ISMs, a three-year period following graduation is granted to enable the country to negotiate a "smooth transition" process with its development partners, so as to avoid disruption to development plans and programmes. The CDP continues to monitor the progress of graduating countries following their graduation and UNCTAD provides technical assistance to accompany the country during this phase.

D. The evolution of the least developed country list

After a transition period of at least three years, graduating countries lose access to LDC-specific ISMs.

In principle, it might seem reasonable to expect that the list of LDCs would become shorter over time, as countries escape from the vicious circles outlined above – particularly as the primary objective of establishing the LDC category was to allow countries to develop sufficiently, through ISMs and national development strategies, to be able to engage more successfully in global markets.

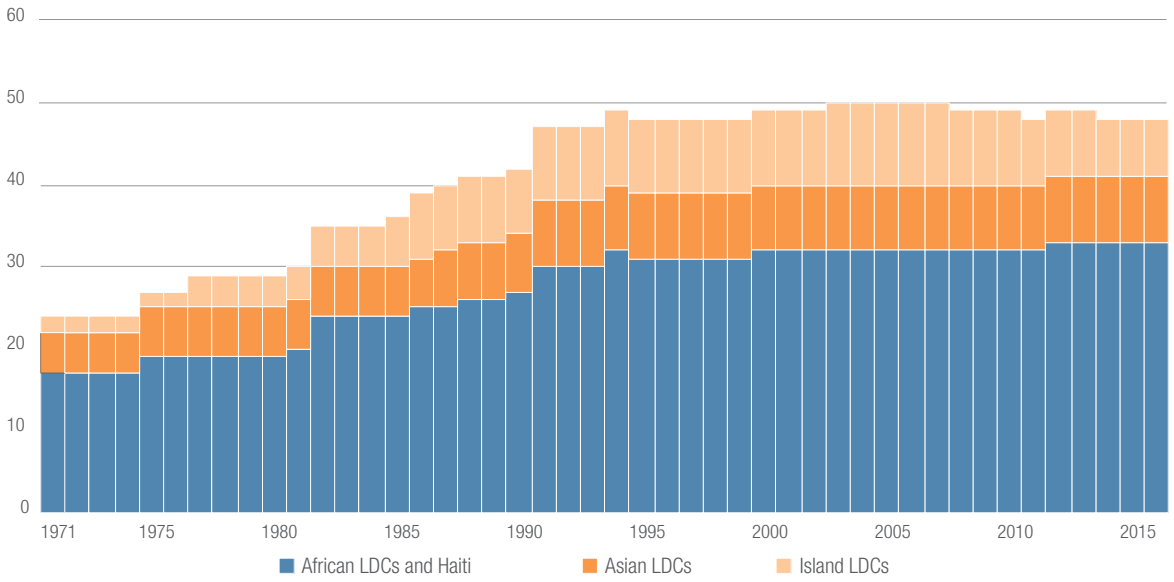
In practice, however, this has not been the case. On the contrary, the number of LDCs doubled from the original list of 25 in 1971 to a peak of 50 between 2003 and 2007, declining only to 48 since 2014 (figure 1.5). However, while this has been partly a result of changes in country circumstances, two other factors have been largely responsible: countries gaining independence (including by secession from existing States); and changes in the LDC criteria and the graduation thresholds (box 1.2).

The number of LDCs doubled from 25 LDCs in 1971 to 50 in 2003–2007, and has since fallen only to 48.

The geographical composition of the group has varied relatively little since 1971 (figure 1.5). The main change has been the increase in the proportion of island economies, from 8 per cent (2 of 25) when the category was established in 1971, to 20 per cent (8 of 39) 15 years later, largely reflecting the late attainment of independence by many countries in this group.

As well as the number of new countries becoming LDCs, the near doubling of the size of the group in the last 45 years in part reflects the small number of countries graduating out of the category — just four in the 25 years since

Figure 1.5. Number of LDCs by geographical group, 1971–2016



Source: UNCTAD secretariat elaboration, based on CDP and UNDESA (2015).

the principle of graduation was established (Botswana in 1994, Cabo Verde in 2007, Maldives in 2011 and Samoa in 2014). While these limited numbers in part reflect relatively slow progress towards the graduation thresholds, they may also reflect changes in the economic and political calculus of graduation, as discussed in section F below.

After 45 years of relative stability, however, the expected increase in the number of countries expected to graduate in the coming years, if realized, is likely to give rise to much more significant changes in the composition of the group. This is discussed in chapter 2.

To date, only four countries have graduated from LDC status: Botswana, Cabo Verde, Maldives and Samoa.

E. The least developed country category: More relevant than ever

1. Economic divergence and the growing concentration of social deprivation

The global economy and the landscape for development have changed dramatically since the LDC category was introduced. Nonetheless, it unquestionably remains valid. Indeed, it is of greater relevance than ever. Some ODCs, particularly emerging economies, have grown strongly, and their per-capita incomes have converged rapidly towards the global average. Despite some improvement in their growth performance in the early part of the twenty-first century, the LDCs have been left ever further behind.

Widening economic and social gaps between LDCs and ODCs make the LDC category more relevant than ever.

Thus, the average GDP per capita of ODCs and countries with economies in transition (as a single group) has increased by nearly half relative to that of the world as a whole in just 16 years, from 28.4 per cent in 1998 to 42.8 per cent in 2015. By contrast, the figure for (current) LDCs rose by barely a quarter over the same period, from 5.8 per cent to 7.3 per cent; and even this increase did little

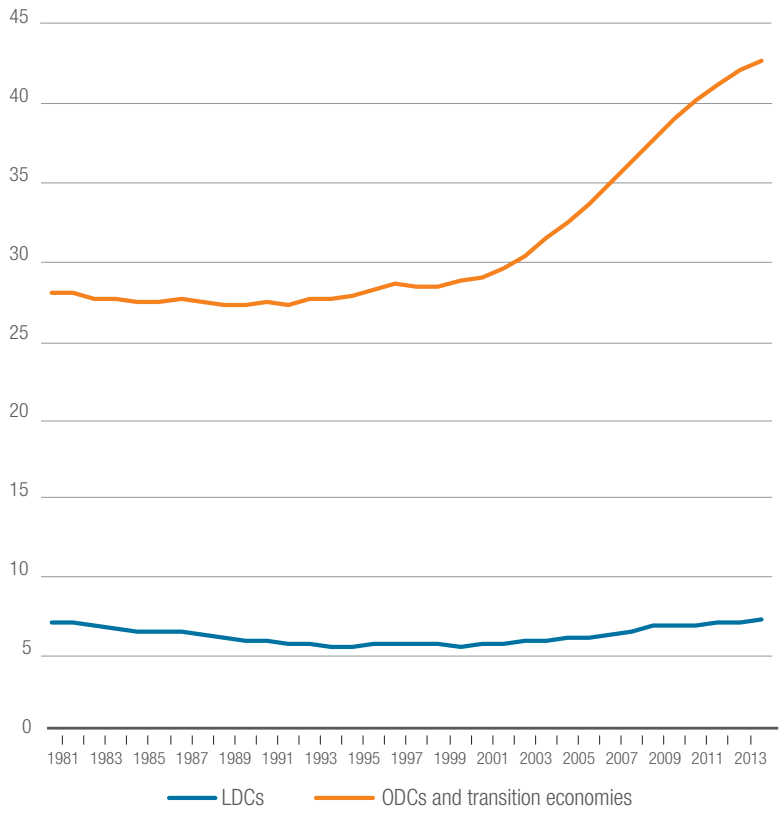
more than reverse the reduction experienced since the early 1980s (figure 1.6). The GDP per capita of LDCs as a whole has fallen almost continuously relative to that of ODCs and countries with economies in transition since 1981, from more than a quarter to barely one sixth. This ratio fell in all but 5 of the 33 years from 1981 to 2014.

LDCs have also fallen ever further behind in terms of social indicators in recent decades (figure 1.7). While their share in the world population has increased only from 9.7 per cent to 12.8 per cent since 1990, the proportion of extreme poverty accounted for by LDCs has doubled from less than 20 per cent to nearly 40 per cent, accelerating markedly since the beginning of the current economic and financial crisis which broke out in 2008. Over the same period, the share of people in LDCs without access to electricity has increased by two thirds, from 31.8 per cent to 53.4 per cent; and the share of people without access to water has more than doubled, from 20.0 per cent to 43.5 per cent.

LDCs' GDP per capita has fallen almost continuously relative to ODCs and transition economies since 1981.

This further highlights the contemporary relevance of the LDC category, particularly in light of the increased emphasis on social goals embodied in the 2030 Agenda and the Sustainable Development Goals, which have the avowed aim of "leaving no one behind". The LDCs are the epitome of those left behind in the global economy, both economically and in human development; and, as observed in *The Least Developed Countries Report 2015* (UNCTAD, 2015a), their increasing share of the social ills addressed by the Sustainable Development Goals makes them the battleground on which the 2030 Agenda will be won or lost. If extreme poverty is to be eradicated globally by 2030, in line with the 2030 Agenda, it must be eradicated everywhere; and it is in the LDCs that extreme poverty is systematically most generalized and most severe, and where it is falling most slowly. A similar logic applies to other Sustainable

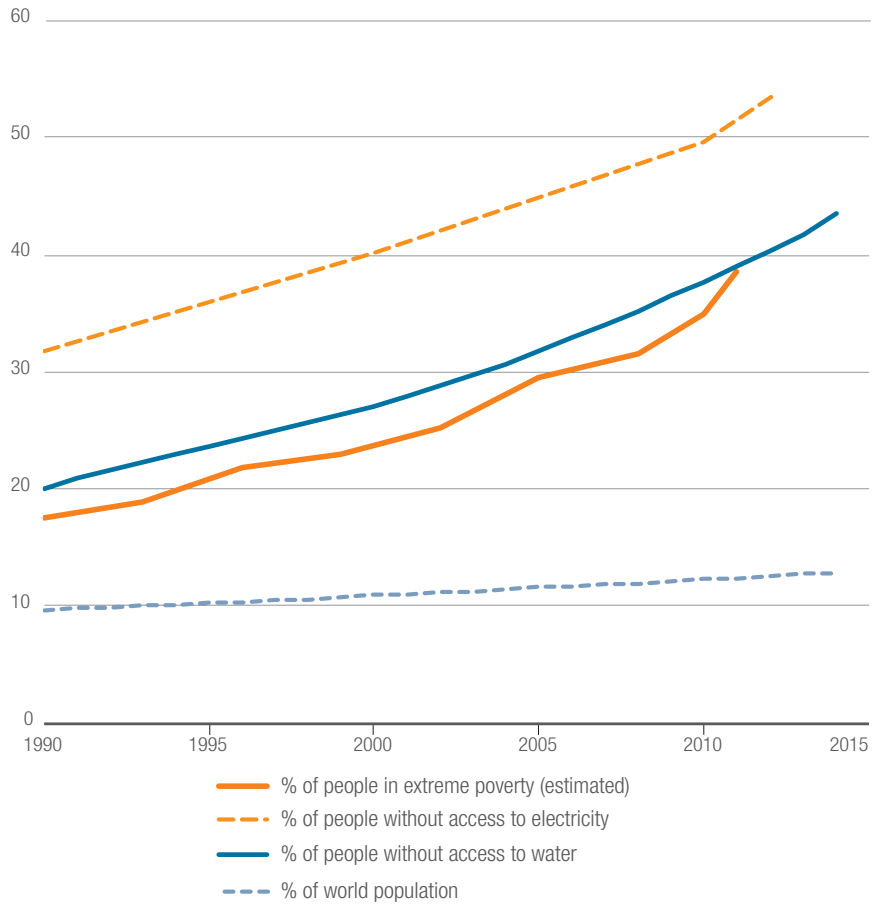
Figure 1.6. LDC and ODC GDP per capita as percentage of world average, 1981–2014



LDCs now account for twice as large a proportion of global poverty and of people without access to electricity as in 1990.

Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed May 2016).

Figure 1.7. LDCs' share in world population, poverty and infrastructure shortfalls, 1980–2014



Source: UNCTAD secretariat estimates, based on data from World Bank, World Development Indicators database and World Bank, PovcalNet database (both accessed April 2016).

Notes: Figures for extreme poverty are approximate, and based on a poverty line of $1.25 per day at 2005 purchasing power parity (PPP) (due to the unavailability of data for some LDCs at 2011 PPP at the time of writing). The estimates provided are based on the overall poverty headcount ratio for all LDCs for which data are available, multiplied by the total population for all LDCs. Since no data are available for Afghanistan, Angola (before 2002), Equatorial Guinea, Eritrea, Kiribati, Myanmar, the Solomon Islands, Somalia, Tuvalu and Vanuatu, this effectively assumes that the average poverty headcount ratio across these countries is equal to the average across the other LDCs.

The 2030 Agenda aims to "leave no one behind" - and the LDCs are the epitome of those left behind in the global economy.

Development Goal targets, such as access to water, sanitation and electricity, preventable child deaths and children out of school. Achieving such outcomes will require both very close attention to the LDCs and continued and enhanced international support.

Economic divergence has reflected, and is reflected in, a widening gap in productive capacities.

2. Divergence in productive capacities

The economic divergence between LDCs and ODCs has reflected, and is reflected in, a widening gap in their productive capacities. Advanced education is critical to the development of productive capacities, not only in the fields of science and technology, but also in areas such as management, and business and public administration. However, tertiary education enrolment ratios in LDCs have fallen progressively further behind the overall figure for developing countries. Even in relative terms, there was only a brief convergence, from 2004 until 2010, and the absolute gap has continued to widen (figure 1.8). In 1970, the tertiary enrolment ratio in LDCs was 1.6 per cent, compared with 4.0 per cent across developing countries as a whole; by 2013 the ratio had increased

to 26.4 per cent for developing countries as a whole, but only to 9.0 per cent in LDCs – a level attained by the developing world as a whole in 1996. Moreover, retention of high-level human capital is as important, and can be as problematic, as its production. Not only is the supply of graduates in LDCs barely one third of that in ODCs, but the "brain drain" is substantially greater, further widening the gap: the proportion of graduates from LDCs living abroad is more than half as much again as in ODCs, at 12.4 per cent in 2000, compared with 7.9 per cent for ODCs (UNCTAD, 2007).

The widening LDC-ODC gap can be seen in tertiary education and graduate emigration…

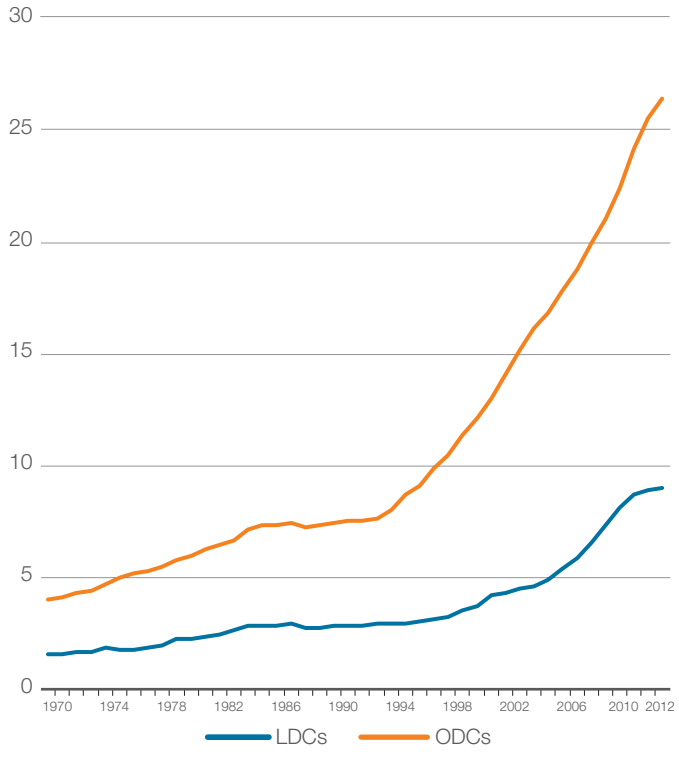
There is also a widening technological gap between LDCs, on the one hand, and ODCs and developed countries on the other, a trend documented by previous UNCTAD research (UNCTAD, 2014b). A dramatic divergence has occurred in their respective science and technology outputs. The ratio between the number of patents filed per capita by ODC and LDC citizens soared from 35 in 1980 to 907 in 2014, reflecting a strong intensification of ODC efforts in science and technology, and a virtual stagnation in LDCs (figure 1.9A). The share of middle and high skills- and technology-intensive manufactures in total merchandise exports (an indicator of export sophistication) has consistently been around 10 times higher in ODCs than in LDCs, and the gap has widened still further in recent years (figure 1.9B).

The divergence in energy use – another important measure of productive capacities – has also been dramatic (figure 1.10). Between 1971 and 2013, per-capita energy use in LDCs increased by only 12.5 per cent, compared with 169 per cent across ODCs.

Financial depth and inclusion is another important enabler of the development of productive capacities, given its role in financing productive investment (UNCTAD, 2006), as well as in channelling remittances to development in

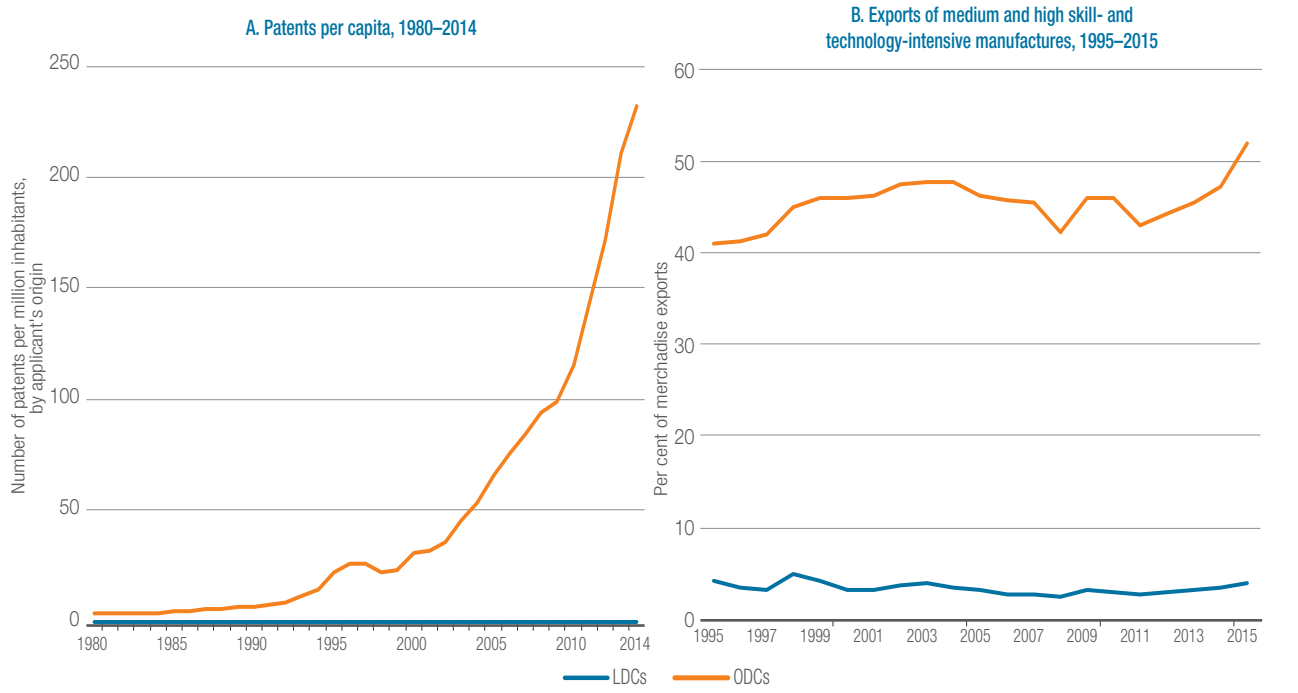
…patent registration and skills- and technology-intensive manufactured exports.

Figure 1.8. Tertiary education enrolment ratio, LDCs and ODCs, 1970–2013



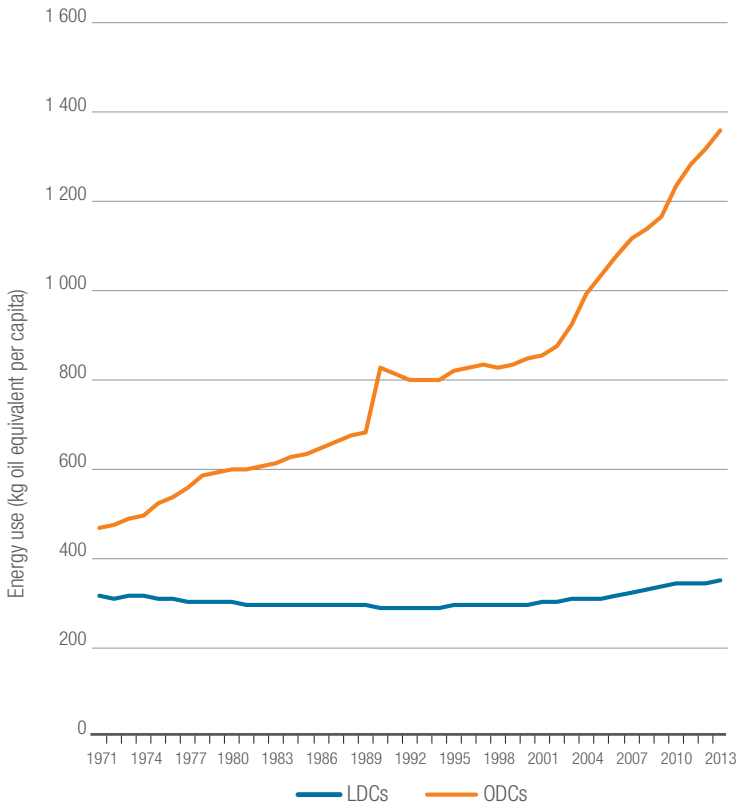
Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed April 2016).

Figure 1.9. Selected indicators of technological capabilities in LDCs and ODCs



Source: UNCTAD secretariat calculations, based on data from World Intellectual Property Organization, WIPO Statistics Database; and UNCTADstat database (both accessed September 2016).

Figure 1.10. Per capita energy use, LDCs and ODCs, 1971–2013



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed April 2016).

countries with large diasporas (UNCTAD, 2012). In most LDCs, less than 20 per cent of the adult population have an account with a financial institution, while in only four (Bhutan, Nepal, Rwanda and Zambia) is the rate above 30 per cent. In the majority of ODCs, by contrast, the corresponding rate is higher than 40 per cent — a rate not achieved by any LDC. By the same token, only two LDCs (Angola and Bhutan) have more than 10 commercial bank branches per million inhabitants, while it is above this level in two thirds of ODCs (figure 1.11).

The gap can also be observed in per-capita energy use and financial depth and inclusion.

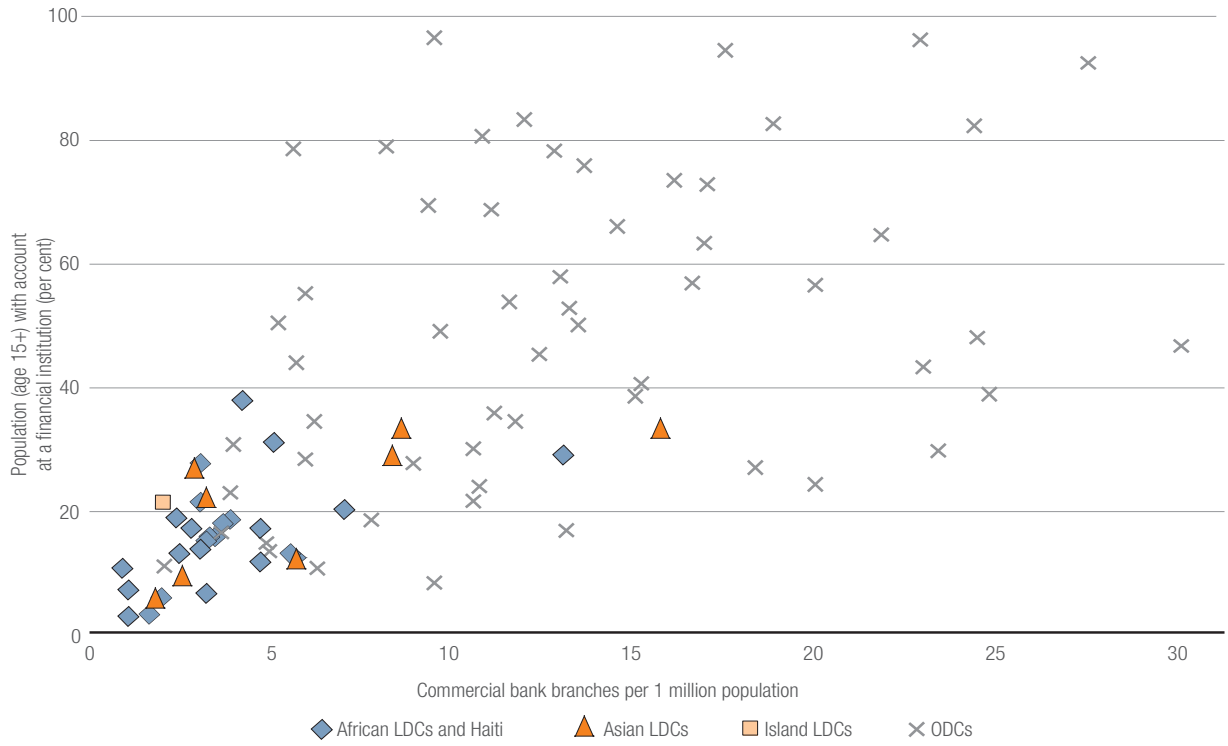
Despite remarkable progress in the adoption of new information and communications technologies (ICTs) in some LDCs, here, too, they have lagged well behind ODCs (figure 1.12 and table 1.1). The median level of Internet access is less than one fifth of that in ODCs across LDCs as a whole, and one ninth in African LDCs and Haiti (9.0 and 5.8 users per 100 people, respectively, compared with 44.7). Even in Asian LDCs the figure is barely a quarter of that for ODCs. Mobile telephone subscriptions are also much more limited in LDCs — a median of 65 per 100 people compared with 110 in ODCs. Asian LDCs again fare somewhat better, but are also far behind ODCs at 77.5, while island LDCs have slightly fewer subscriptions than African LDCs and Haiti (62.7, as against 64.0).[7] The gaps in physical ICT infrastructure are much greater: in 2014, ODCs had an average of 34.3 secure Internet servers per million people, compared with only 1.5 per million in LDCs.[8]

Despite remarkable progress, wide gaps also remain in ICT infrastructure.

3. The changing global economic environment for development

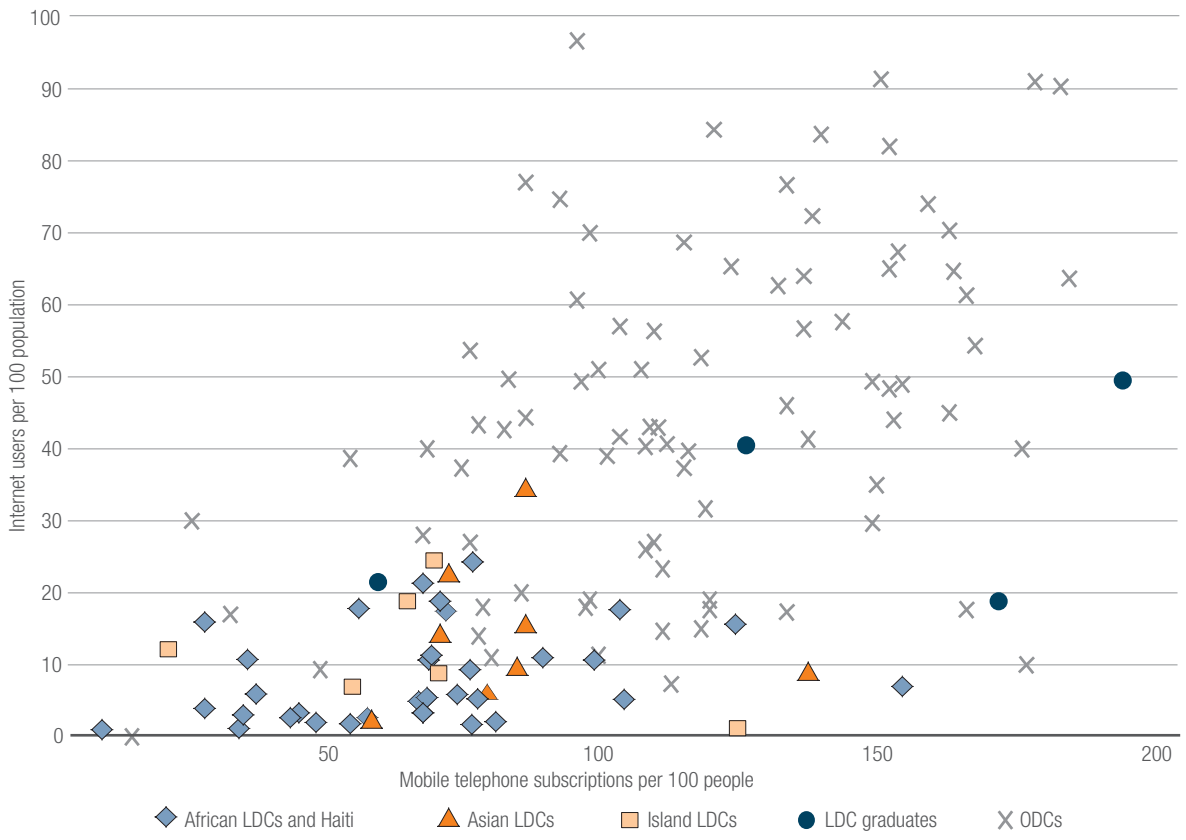
The divergence between LDCs and ODCs described above, in terms of economic and social indicators and productive capacities, is closely linked with fundamental shifts in the nature of the global economy in recent decades,

Figure 1.11. Access to financial services, LDCs and ODCs, 2011–2014 (latest)



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed May 2016).

Figure 1.12. ICT access, LDCs, ODCs and graduating countries, 2014



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed May 2016).

Table 1.1. Median access to ICTs by country group, 2014

	Mobile telephone subscriptions	Internet users	Secure Internet servers
	(Per 100 population)		*(Per 1 million population)*
LDCs (total)	64.9	9.0	1.5
African LDCs and Haiti	64.0	5.8	1.4
Asian LDCs	77.5	11.9	1.6
Island LDCs	62.7	10.6	9.1
LDC graduates	144.5	30.7	40.9
Other developing countries	110.1	44.7	34.3

Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed May 2016).

particularly from a development perspective (UNCTAD, 2015b). In particular, this divergence is related to the major increase in the role of commercial transactions, and the corresponding reduction in the relative importance of non-market mechanisms, since the inception of the LDC category. This is clearly demonstrated in figure 1.12, above. Trade has increased from around 12 per cent of global GDP in the 1960s to around 30 per cent since 2011. FDI has risen from an average of 0.4 per cent of global GDP between 1970 and 1985 to between 2 per cent and 5 per cent since 1998. ODA, by contrast, fell by nearly half relative to global GDP, from 0.35 per cent in the early 1960s to an average of less than 0.2 per cent since 1996. By contrast, migrants' remittances, which were less than half as much as ODA in the early 1970s, are now three times as great as ODA. FDI flows, which were around 1.5 times greater than ODA in the 1970s and early 1980s, have been between 10 and 20 times greater since 1997.

Divergence is also linked to the shift in the global economy from ODA to commercial transactions.

In the context of LDCs and graduation, this has three critically important implications. First, the major increase in the importance of trade and international investment in the global economy has made success in development ever more dependent on effective engagement with export markets and foreign investors, and latterly on being able to secure a position in higher-value segments of GVCs. This has dramatically highlighted the gap in productive capacities between LDCs and ODCs, intensifying its effects on the LDCs' prospects for success.

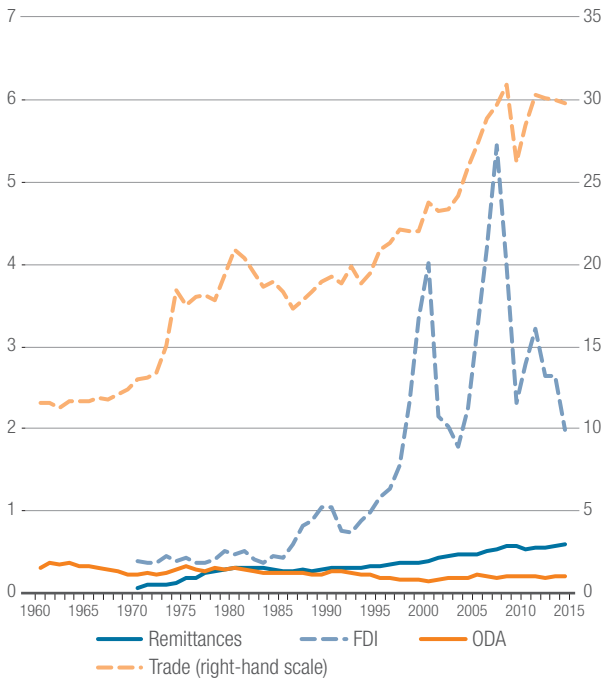
Second, the greatly increased flows of trade and international investment have strengthened the rewards available to those countries that are most successful in competing for them. Together, these two factors have made an important contribution to the increasing divergence between LDCs and ODCs in economic and human development highlighted above. At the same time, this has increased the need for effective international support to the development of productive capacities in LDCs, to enable them to compete more successfully in a changing international landscape.

The growing importance of international markets intensifies the effect of the divergence in productive capacities on LDCs' prospects…

Third, the decline in ODA relative to private capital flows and trade has limited its impact. Its effectiveness has also been impaired by extraneous influences on its allocation, such as commercial, financial, geopolitical and domestic political considerations rather than relative needs (Alesina and Dollar, 2000; Dollar and Levin, 2006). In the 1960s, ODA per capita to the countries that are now LDCs was approximately equal to that to ODCs, increasing only slowly during the course of the decade. Following the official recognition of the LDC category in 1971, however, ODA to LDCs increased dramatically, peaking at 3.5 times that for ODCs in per-capita terms in 1987. Thereafter, however, the trend was reversed, the ratio having fallen to 2 by 1999. Despite the inclusion in the Millennium Development Goals and the 2001 Programme of Action for the Least Developed Countries for the Decade 2001–2010 (the Brussels Programme of Action) of a target of 0.15–0.20 per cent of donor GNI for ODA to LDCs, the

…widening the economic gap with ODCs and increasing the need for more effective international support.

Figure 1.13. ODA, trade, FDI and remittances as percentage of world GDP, 1960–2015



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed April 2016).

ratio has fluctuated widely in a range between 2 and 3 since 2000, but with no clear trend (figure 1.14).

F. Graduating to what?

1. A MILESTONE, NOT THE WINNING-POST

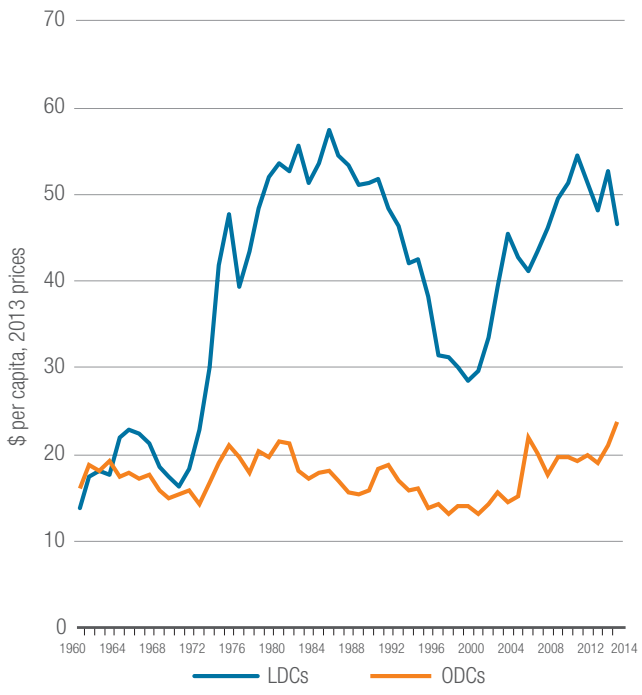
The criteria for LDC status do not signify a clearly defined boundary between fundamentally different economies.

The above discussion highlights the importance of considering graduation from the LDC category in the context of a broader and longer development process. While developing countries are often divided into broad categories, of which the LDCs are one, these do not generally represent clearly demarcated groups. Rather, developing countries are spread across a continuous spectrum, whether in terms of income, commodity dependence, fragility or any other criterion or set of criteria. The precise criteria for LDC status do not signify a clearly defined boundary between fundamentally different economies, any more than the threshold between the low- and middle-income, or between the lower- and upper-middle-income categories. A degree of arbitrariness is inevitable in any such classification.

This progressive nature of development means that graduation — and still more the achievement of the statistical criteria for graduation — is not an end in itself. It marks the end of a *political and administrative* process, but not the completion of an *economic or developmental process*. Rather, it should indicate that a certain minimal level of development has been achieved as the initial stage of a single continuous process – that the threshold has been crossed from dependency on ISMs to a capacity to rely primarily on markets.

Graduation is not the winning post of a race to leave the LDC category, but the first milestone in the marathon of development.

Figure 1.14. Real ODA receipts per capita, LDCs and ODCs, 1960–2014



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed March 2016).

Graduation is thus not the winning post of a race to cease being an LDC, but rather the first milestone in the marathon of development. This has critically important implications for LDCs' approaches to development and to graduation. Just as it is inadvisable to sprint for the first kilometre of a marathon, it is not enough simply to target achievement of the criteria needed for graduation: it is also necessary to establish the foundations needed to maintain development progress *beyond* graduation. Focusing exclusively on the graduation indicators risks diverting attention and resources from other aspects of development that will be critical long after graduation has been achieved.

Income-only graduation may provide a weak basis for later development, especially when based on extractive sectors.

This is of particular importance because many of the prerequisites for development are dependent on prior actions and/or subject to very long time lags, and their effectiveness and sustainability can be seriously impaired by attempting to compress such actions into an unrealistically short period.

This applies particularly — but by no means exclusively — to the income-only route to graduation. As the experiences of Angola and Equatorial Guinea demonstrate, it is possible for an LDC to reach the income level necessary for graduation with limited progress either on human assets or on economic vulnerability. Particularly where growth is based on an extractive sector that operates essentially as an enclave, this may provide a very weak basis for post-graduation development, unless resource rents are effectively used to support a deeper and more broadly based development process.

How the income criterion is met may be as important as when it is met, and the nature of growth as relevant as the rate of growth.

Even where countries qualify for graduation on the basis of two criteria (typically income per capita and the HAI), similar issues arise. Important as the indicators underlying these criteria unquestionably are, there are many critical aspects of development that they capture only indirectly or to a limited extent. Graduation may thus be achieved with relatively limited progress in key areas such as infrastructure, structural transformation, and effective institutions and governance. However, if the necessary foundations are not laid in these areas, they are likely to constrain post-graduation development.

This means that how the income criterion is met (that is, the nature of growth) may be as important as when it is met (the rate of growth). Moderate but broadly based growth, founded upon the development of productive capacities (which entails increasing productivity, structural transformation and infrastructure development), may well be more conducive to development success in the long term than faster growth with weaker foundations, even if the latter leads to faster graduation.

Focusing only on the specific indicators used in the graduation criteria is not enough…

Equally, some caution is needed with respect to the components of the human assets indicator. Focusing on improving under-5 mortality statistics, for example through concentrating on vertical immunization programmes, may well maximize the reduction of child mortality in the short term, and hence progress towards meeting the human assets criterion for graduation. Important as child immunization unquestionably is, however, a greater emphasis on the development of effective health systems may provide a more solid foundation for development beyond graduation, as well as broader and more sustainable progress on child health.

Similarly, progress towards graduation can be maximized by focusing on increasing the secondary school enrolment ratio — that is, providing more classrooms and promoting school attendance. In developmental terms, however, merely having children in classrooms is not enough: the nature and quality of education, though less readily measurable, is also critical. Moreover, given the time lags inherent in child education, long-term development requires attention to prospective needs a decade or more in the future. Those children

beginning education now will be the pool of adults from which the graduates and post-graduates available in 15–20 years will be drawn.

Thus the nature of the graduation criteria, and of their individual components, need to be borne in mind. Indicators are selected for this purpose primarily on the basis, first, that they have a strong correlation with key aspects of development; and, second, that they are readily and objectively measurable. The latter is of particular importance in LDCs, where reliable data collection is limited by a combination of financial and human resource constraints, institutional limitations, and logistical factors such as low population densities and poor transport and communications infrastructure.

…as the picture of development they provide is inevitably imperfect and incomplete.

While the indicators are readily measurable, the picture they provide of the development process is inevitably imperfect and incomplete. To target improvements in the specific indicators would be to place excessive emphasis on certain objectives because they are readily measurable, rather than on the basis of their importance — for example, on child mortality rather than other aspects of child and adult health or the establishment of effective health systems. This would be suboptimal from a longer-term development perspective.[9]

Graduation strategies should focus primarily on long-term development needs, to achieve graduation with momentum.

This suggests that a graduation strategy should focus primarily on the needs of the long-term development process rather than on the particular criteria used to assess graduation. This is referred to in this Report as "graduation with momentum" — graduation from LDC status in such a way as to provide a solid basis for sustained development progress subsequently, allowing the pitfalls of the later stages of development to be avoided.

2. Graduation with momentum: The key role of productive capacities

The key to such a process of graduation with momentum is the development of productive capacities — an issue consistently highlighted in *The Least Developed Countries Report* series (most notably UNCTAD, 2006). This entails a shift of production towards more sophisticated goods and services, through investment in technological upgrading of productive facilities and the establishment of new sectors and activities; and diversification and upgrading of the export structure towards a greater number of higher-value-added products. A key aspect is the production, not only of new, but of "better" products – those generating a greater proportion of value added in the country, with forward and backward linkages and positive externalities. Further elements include improving product quality, product differentiation to earn a market premium, and increasing domestic supply of the services associated with production.

Graduation with momentum requires the development of productive capacities, leading to structural transformation…

Such development of productive capacities leads to structural transformation of the economy, shifting labour and capital from less productive to more productive sectors and activities (UNCTAD, 2014c), and contributes to creating the jobs needed for the growing LDC population with higher levels of labour productivity and value addition, thus raising living standards (UNCTAD, 2013b). This process of progressively increasing sophistication of production (and export) structures lies at the core of successful development trajectories (Hausmann et al., 2007).

...to enable LDCs to cope with their vulnerability to economic and environmental shocks.

Such a "virtuous" pattern of development, founded upon the development of productive capacities and structural transformation, is also essential to increasing LDCs' ability to cope with their acute vulnerability to external risks and shocks, particularly economic shocks (stemming from factors such as commodity dependence, chronic current account deficits, dependence on imports of essential inputs, the combination of small economies and openness,

and constraints to raising fiscal revenues) and environmental shocks (such as natural disasters and climate change impacts, in some cases compounded by geographical factors). Since such vulnerabilities tend to hamper investment and thus jeopardize development, increasing resilience further contributes to progress towards graduation and subsequent development.

At some point along this trajectory — in principle marked by graduation — LDCs should cease to need LDC-specific ISMs and be able to face international competition on the basis of the productive capacities they have developed. However, this is but one step along the development continuum, and they often continue to face challenges such as commodity dependence and vulnerability to a greater or lesser extent. The need to continue developing productive capacities and upgrading the productive base is thus a permanent one.

The concept of graduation with momentum accords closely with the 2030 Agenda.

The concept of graduation with momentum also accords closely with the 2030 Agenda. In contrast with the previous Millennium Development Goals, the Sustainable Development Goals incorporate a balanced treatment of the economic, social and environmental dimensions of sustainable development, fully recognizing the interdependence among them. Sustainable Development Goals 1, 8–12 and 17, in particular, imply achieving sustainable development through the development of productive capacities, structural transformation, technological upgrading, diversification, rising productivity and the creation of more and better jobs. Thus, to pursue the Sustainable Development Goals in a similarly balanced manner implies a development strategy consonant with that long advocated by *The Least Developed Countries Report* series and summarized in figure 1.14. If LDCs were to achieve the Goals and their targets fully, they would in doing so also achieve graduation with momentum.

If LDCs meet the SDGs, they will in doing so also achieve graduation with momentum.

In practice, of course, such an ideal graduation-with-momentum scenario is by no means always achieved. While the graduation criteria are intended to ensure that graduating countries are fully capable of pursuing their development process in the post-graduation phase in the absence of ISMs, they are inevitably imperfect, and can omit some important aspects of development. As discussed in chapter 2, some countries may thus graduate without having achieved significant structural transformation.

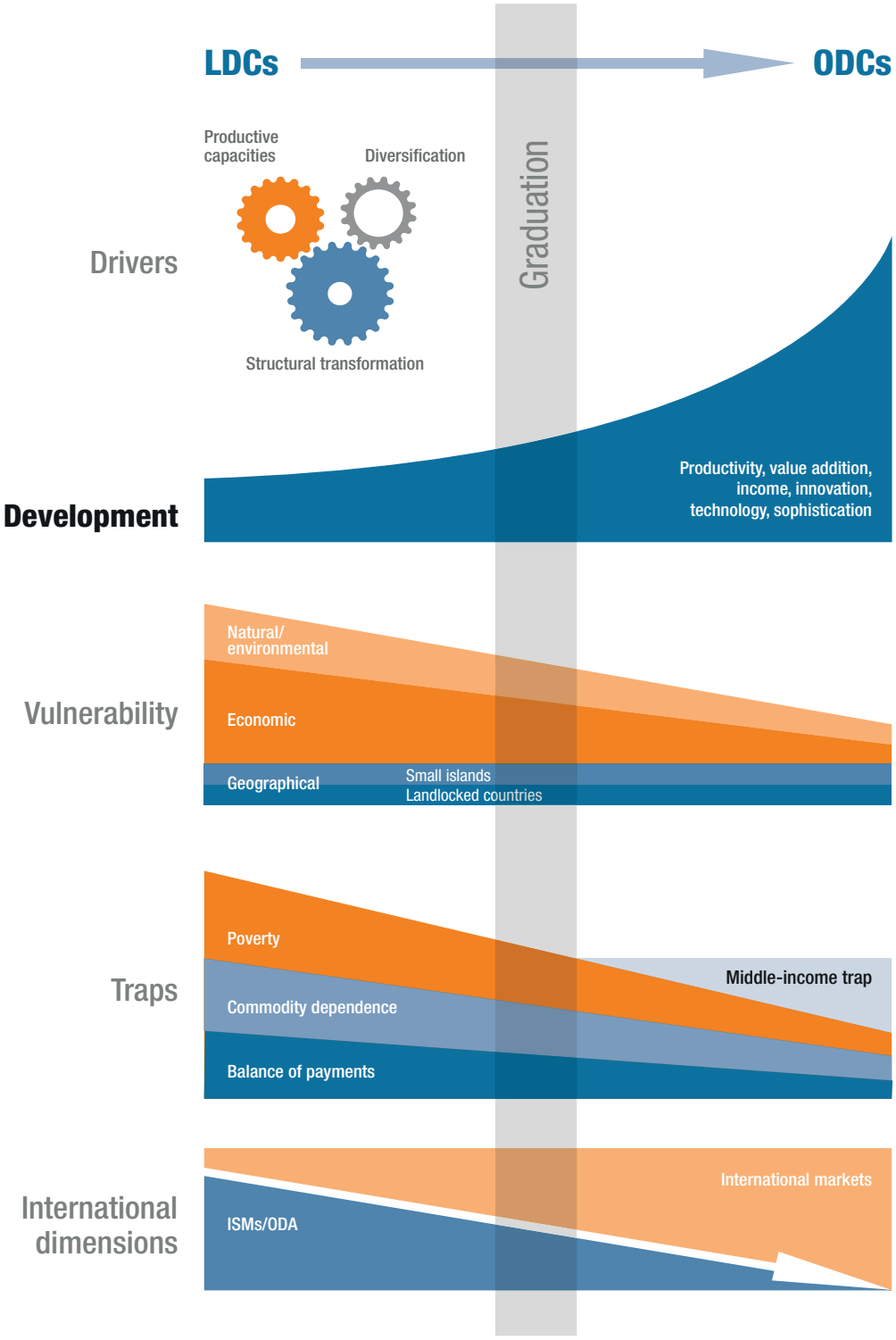
3. The key role of inclusivity and gender

The structural transformation and development of productive capacities essential to graduation with momentum require making full use of productive resources, not least human resources. This requires harnessing the productivity, skills, talents, creativity and entrepreneurial vigour of the entire population effectively for development. Given the potentially transformative role of women's empowerment, greater gender equality in access to education, employment opportunities and factors of production is an important aspect of this.[10] Graduation with momentum can best be achieved and sustained by ensuring inclusiveness in access to and use of productive resources, including through implementation of gender-specific measures where appropriate to overcome the particular disadvantages faced by women.

Some countries may graduate without achieving significant structural transformation.

Women in LDCs face particular constraints to their access to productive resources and markets. Their disadvantages in reproductive health, empowerment and the labour market are particularly striking: the United Nations Development Programme (UNDP) gender inequality index for LDCs in 2015 amounted to 0.57, compared with 0.45 for developing countries as a whole.[11] LDCs also perform significantly less well than ODCs on the UNDP's gender development index (based on the female-to-male ratios of indicators relating to health, education and command over economic resources). In 2014, the

Figure 1.15. LDC graduation and sustainable development



Source: UNCTAD secretariat.

overall gender development index of LDCs was 0.87, compared with 0.90 for developing countries as a whole. Of the 36 LDCs for which data are available, 26 are in the lowest of five categories based on this index, and a further six in the second lowest group. Only four LDCs, all in Africa, performed better: Madagascar and the United Republic of Tanzania were classified in the middle group, while Lesotho and Rwanda were in the second highest group (UNDP, 2015: table 4).

The cost of failing to address gender parity effectively is considerable. The *Africa Human Development Report 2016* (UNDP, 2016) estimated the cost of gender inequality in labour markets in sub-Saharan Africa in 2014 at $105 billion (6 per cent of GDP). Reducing such costs requires realizing the potential contribution of women to development, by identifying and addressing the particular constraints they face in accessing education and labour and other markets. Women typically face time constraints arising from obligations to care for other family members; discriminatory practices and cultural norms that limit access to labour (and other) markets; gender assignment of roles and tasks (notably in agriculture) and occupations; lack of control over the proceeds of crop sales in agriculture; lack of financial inclusion and access to financial services; limited access to education and training; and discriminatory practices, customs and laws (for example, in relation to land ownership, titling and inheritance).

Loss of access to LDC-specific ISMs after graduation may give rise to economic costs...

Though by no means exclusively a rural issue, gender inequality tends to be particularly marked in rural areas, and is therefore of particular relevance to the transformation of rural economies (UNCTAD, 2015a: chap. 4). Gender-based obstacles, compounded by other market imperfections in rural areas, reduce women's productivity and inhibit their entrepreneurial potential, slowing the transformation of rural economies. Unless such constraints are addressed, the supply response to incentives aimed at increasing production will remain weak, as half the population will be unable to respond effectively. Estimates made by the Food and Agriculture Organization of the United Nations (FAO, 2011) suggest that total agricultural output could be increased by between 2.5 per cent and 4 per cent if women were provided with the same access to productive resources as men.

G. The economic and political calculus of graduation

1. The economic calculus

Graduation should in principle be a reflection of development in terms of income per capita, human assets and economic vulnerability; and this development, in itself, has clear economic benefits. However, these benefits may be increased or reduced by the economic effects of graduation (that is, of the loss of LDC status itself); and these potential effects are a key element in LDCs' approaches to graduation.

...but there could also be benefits in terms of international market perceptions.

A key result of graduation from LDC status is that the graduating country, after the three-year transition period, loses access to LDC-specific ISMs. This is a potentially significant economic cost, as further analysed in chapter 4 of this Report. However, the importance of ISMs to a graduating country depends on the benefits it derived from them while it was an LDC. As discussed in chapter 3, such benefits are often subject to major constraints and limitations.

It is also possible that there may be indirect costs of graduation. The increasing emphasis on LDCs within the development cooperation discourse, for example, could contribute to a reduction in ODA receipts following graduation. Once a country has graduated, the ODA it receives no longer contributes to the donor country's performance against the target of 0.15–0.20 per cent of GNI for ODA to LDCs. To the extent that this target is regarded as a significant policy objective in donor countries, this could contribute to a reallocation of ODA from a graduating country towards the remaining LDCs.

Against this, however, graduation may have more positive effects. While LDC status may confer benefits in terms of access to ISMs, graduation may have (or be perceived by governments as having) potential benefits in terms of commercial relations, particularly its attractiveness to foreign investors. Market perceptions are important, most notably to FDI, credit ratings, and access to and the cost of international lending. Such benefits could, in principle, outweigh any losses associated with the loss of access to ISMs.

The graduation costs and benefits evolve over the course of development…

The economic calculus of graduation therefore rests on the balance between these positive and negative aspects; and this balance is likely to evolve over the course of development. At the earliest stages of development, a country's attractiveness to foreign investors (at least outside extractive industries) is limited by low incomes, limited human capital, weak infrastructure, relatively poor health and nutrition, and often economic, social and/or political instability. The potential benefits of graduation in terms of FDI are therefore likely to become progressively more important as development progresses, and the country becomes potentially more attractive as a destination for FDI.

The evolution of the effects of ISMs over the course of development is less clear-cut. While the need for ISMs is likely to be greatest at earlier stages of development, when the ability to compete in international markets is most limited, the potential to exploit and benefit from some ISMs – for example, market access — is dependent on the level of development of productive capacities. The benefits of such ISMs, and hence the potential impact of their loss through graduation, may thus increase as development progresses.

…and as a result of changes in the global economy.

The economic calculus of graduation may also be expected to change over time, in line with changes in the global economy. As noted above, there has been a major increase in the importance of market transactions over time, while ODA to LDCs has failed even to regain its 1980s level in per-capita terms. At the same time, as discussed in chapter 3, the potential benefits of preferential market access have been reduced as the wider process of trade liberalization globally over recent decades has resulted in preference erosion.

Economic considerations are only part of the political calculus of graduation…

The above discussion suggests that the balance of the economic calculus is likely to have shifted significantly towards graduation since its introduction in the early 1990s, as the importance of commercial transactions such as trade and FDI has increased relative to non-market transactions such as ODA. This appears to be confirmed by the historical experience of graduation cases, as discussed in chapter 2.

2. The political calculus

In practice, national policy approaches to graduation (as to other aspects of development) depend not only on economic considerations, but also on a political calculus. While the economic calculus is an important part of this, it is overlain by distinct political considerations, both domestically and at the international level. Domestically, there is a potential kudos effect – the opportunity for a government to enhance its reputation and gain future political advantage by claiming responsibility for having brought a country from LDC status to parity with ODCs. This may have encouraged some LDC governments to develop strategies specifically oriented towards graduation by a specified date.

…as graduation may enhance the government's reputation domestically and the country's status internationally.

Internationally, there may also be a status effect, to the extent that graduation is seen as enhancing the country's image in the global community; and this may be expected to have some positive effect on the country's influence in regional and international forums. Its bargaining power at the international level may also be enhanced by reduced dependency on support from ISMs,

Tensions between the economic and political calculus of graduation may arise.

which are essentially discretionary in nature. Such benefits, in turn, could further reinforce the positive economic effects of graduation. Graduation typically constitutes a culminating moment of national pride, which allows reaffirmation and strengthening of the country's long-term development vision, as was the case, for instance, in Cabo Verde (Resende Dos Santos, 2016).

Either or both of these effects may tend to tip the balance of the political calculus towards seeking to graduate sooner than would be indicated by economic considerations alone. This tendency is likely to be strengthened by political and electoral cycles, to the extent that governments seek to secure the political benefits of graduation during their terms of office.

This gives rise to a potentially significant tension between the economics and the politics of graduation. While the "how" of graduation is more important than the "when" economically, as discussed above, the reverse may be the case politically. While this might improve progress towards achieving the IPoA target for graduation, it may increase the risk that some LDCs will graduate without the momentum necessary for sustained development progress beyond graduation.

LDCs' attitudes towards graduation are essentially a product of the combination of political and economic reasoning mentioned above. The political dividends derived from graduation and the declining economic effectiveness of some of the LDC ISMs arguably explain the shift from an apparent reluctance to graduate during the 1990s and early 2000s to the recent adoption of strategies specifically aimed at rapid graduation.

H. Summary

- The 2011 IPoA for the first time adopted an explicit target on graduation — that at least half of the 49 LDCs at that time should satisfy the graduation criteria by 2020.
- Graduation in principle marks the point at which an LDC has escaped sufficiently from the vicious circles which obstructs its development to benefit from international markets on an equal basis with ODCs.
- Graduation thus marks a shift from dependence primarily on ISMs to dependence on markets — that is, from dependency to a greater degree of self-reliance.
- Graduation is the first milestone in a marathon of development, not the winning post in a race to escape LDC status. It marks the end of a *political and administrative process*, but not the completion of an *economic or developmental process*.
- It is not enough for LDCs to graduate; they need to achieve graduation with momentum, laying the foundations for their subsequent development, to avoid the pitfalls of the post-graduation phase.
- Graduation with momentum requires the development of productive capacities and structural transformation of the economy. This, not the fulfilment of the statistical criteria for graduation, should be the primary objective of graduation strategies.
- Economic and social divergence between LDCs and ODCs, including in productive capacities, makes the LDC category more relevant than ever. This is further reinforced by the 2030 Agenda.
- While the "how" of graduation is more important than the "when" economically, the reverse may be the case politically, giving rise to a potential tension between the two.

Notes

1 At the intergovernmental level, the Comprehensive High-Level Midterm Review of the Implementation of the Istanbul Programme of Action for the Least Developed Countries for the Decade 2011–2020 was held in Antalya, Turkey on 27–29 May 2016.

2 Based on a poverty line of $1.25 per person per day at 2005 purchasing power parity. At the time of writing, data based on the World Bank's revised poverty line of $1.90 per person per day at 2011 purchasing power parity were not available for all LDCs.

3 In the analysis of convergence and divergence in the global economy, economists have spent considerable time and resources to understand why the very richest and the very poorest countries do not converge in output per worker. (See, for example, Ben-David, 1998; Mayer-Foulkes, 2010).

4 In the growth-related literature, a poverty trap is essentially characterized by the presence of multiple equilibria with a locally stable low-level attractor, so that countries spontaneously tend towards the high-level equilibrium only above a given threshold (typically characterized in terms of income and/or investment). The main mechanisms cited as potentially giving rise to poverty traps include: subsistence consumption and demographic issues (which give rise to saving-based non-linearities); increasing returns due to externalities and learning by doing (typically in the manufacturing sector); complementarities across heterogeneous production factors; financial externalities acting on demand; credit market imperfections; coordination failures; and institutional traps (Azariadis, 1996; Azariadis and Stachurski, 2005; Acemoglu et al., 2005).

5 The Sudan and Timor-Leste are other important fuel exporters. The former, however, is classified as a mixed exporter (reflecting the substantial shares in its exports of ores and metals and of services). In the case of Timor-Leste, foreign exchange receipts in the energy sector mostly take the form of royalty payments, which are therefore classified as services exports. Consequently, the country is included in the service exporters category.

6 As of 30 September 2016, the Extended Credit Facility was being used by Afghanistan, Burkina Faso, the Central African Republic, Chad, Guinea, Guinea-Bissau, Haiti, Liberia, Madagascar, Malawi, Mali, the Niger, Sao Tome and Principe, and Sierra Leone, and the Stand-by Credit Facility by Mozambique and Rwanda.

7 It should be noted that these figures include individuals with more than one subscription, a phenomenon which is particularly pronounced in countries where signal coverage from individual providers is limited or unreliable.

8 In this case, island LDCs fare much better than the other LDC groups, with 9.1 secure servers per million people (doubtless reflecting the very small population of most), six times the figure for the other two groups, but still barely a quarter of the median for ODCs.

9 Possible improvements to the LDC criteria are discussed in chapter 5 of this Report.

10 The considerations in this section also apply (in varying degrees in different countries) to other systematically disadvantaged population groups, notably those living in poverty, ethnic minorities, migrants, refugees and displaced people, indigenous peoples, people with disabilities and chronic illnesses, and people living with HIV/AIDS. All of these dimensions also intersect with gender, potentially leaving women in these groups particularly disadvantaged.

11 The gender inequality index is equal to zero when women and men fare equally, and it is equal to 1 when either gender fares as poorly as is possible in all measured dimensions.

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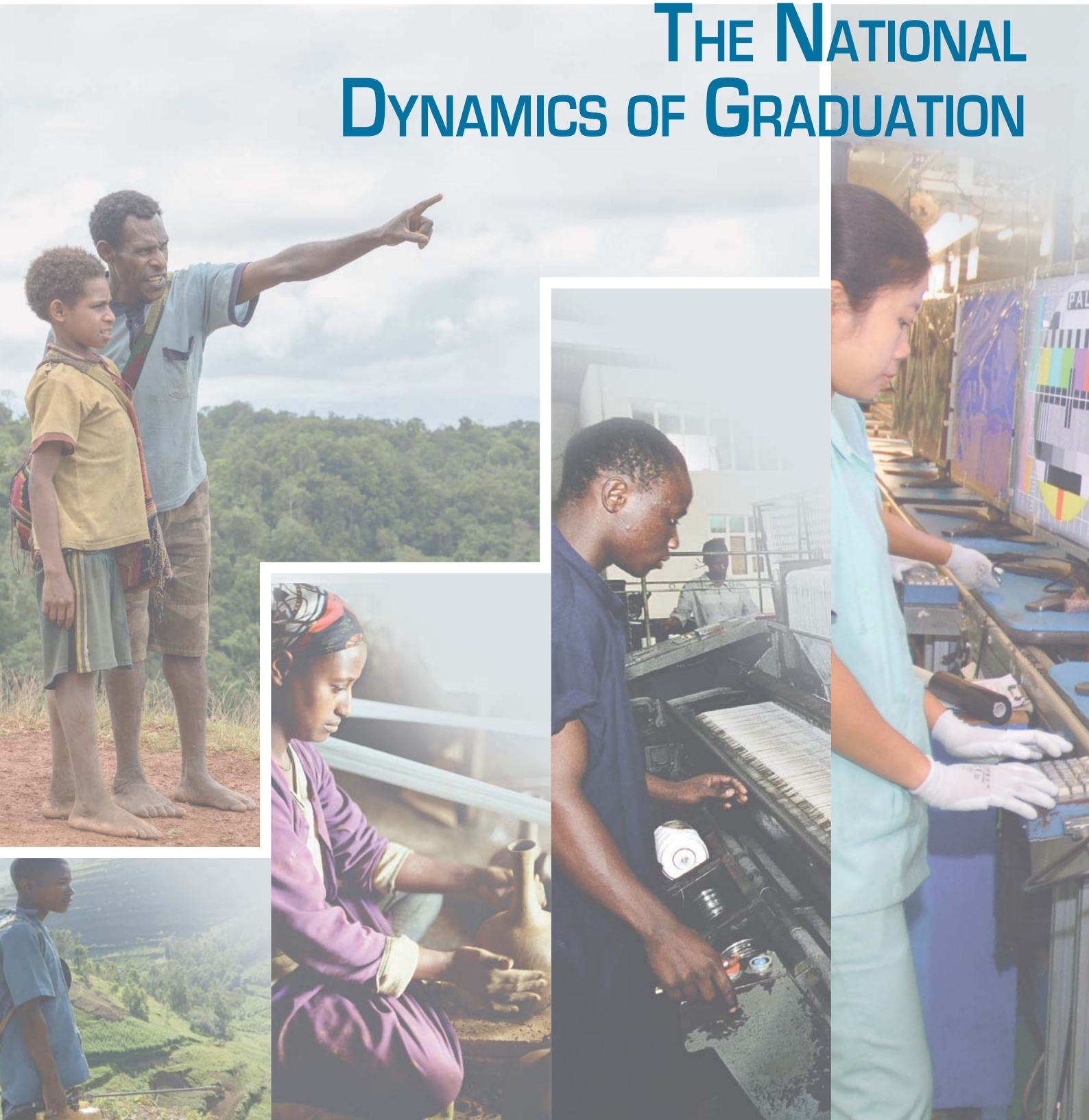
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CHAPTER 2

The National Dynamics of Graduation



A. Introduction

To date, only four countries have graduated from the LDC category.

In the 45 years since the establishment of the least developed country (LDC) category, only four members of the group have succeeded in graduating out of it (Botswana, Cabo Verde, Maldives and Samoa). Even taking account of successive changes to the LDC criteria (as shown in box figure 1.1 of chapter 1), and the absence of provisions for graduation until 1991, this indicates very limited progress towards graduation. It also suggests that neither the domestic policy efforts of LDCs nor the international support measures (ISMs) established to support them have had a decisive effect in improving their development prospects. This chapter addresses the national dimension of this issue, focusing on the processes by which LDCs can emerge from the underdevelopment discussed in chapter 1 and progress towards graduation.

The present chapter begins, in section B, by examining the historical and current cases of graduation and assessing the outlook for graduation of the current LDCs in the period 2017–2024. Section C analyses the role of geographical factors in influencing graduation performance. Section D discusses the domestic processes that have allowed Botswana, Cabo Verde, Maldives and Samoa to graduate, and the national strategies and priorities of the remaining LDCs, from the perspective of the structural transformation required to achieve "graduation with momentum". Section E examines the likely features of the group of LDCs once the next wave of expected graduations has taken place.

None of the four graduates has satisfied the vulnerability criterion.

B. Historical, current and future cases of graduation

The past and current cases of graduation to date are listed in table 2.1. While Botswana graduated in 1994, three years after first meeting the criteria, others took much longer, and several countries that have met the criteria at some point have still not graduated. Samoa graduated 23 years after having met the criteria for the first time, Maldives 14 years after, and Cabo Verde 13 years after. Among these first four historical cases, one was a landlocked country in Africa exporting primarily minerals (mainly diamonds), and three were small island developing states (SIDS), with primarily services exports. All four qualified for graduation by virtue of the income criterion and the human assets index (HAI) criterion (or its forerunner, the augmented physical quality of life index), while none satisfied the vulnerability criterion.

This Report presents indicative projections for graduation until 2024.

For the purposes of this Report, UNCTAD has also assessed the outlook for graduation of the current LDCs in the period 2017–2024, based on the decisions taken by the United Nations General Assembly up to mid-2016 (which take into account the results of the last triennial review, held in 2015), and on projections of the performance of each LDC against the graduation criteria at the time of the triennial reviews of 2018 and 2021. The methodology used in these projections is outlined in box 2.1, and the results are summarized in table 2.2.

The objectives of the exercise were:

(a) To assess the impact of domestic processes in fostering the development of countries' productive capacities and structural transformation and, hence, improving the likelihood of graduation;

(b) To identify the expected cases of graduation from the LDC category during the 2017–2024 period;

(c) To gauge the likelihood of the Programme of Action for the Least Developed Countries for the Decade 2011–2020 (Istanbul Programme of Action (IPoA)) target on graduation being met;

Table 2.1. The history of graduation to date

Country	Year of statistical pre-eligibility for graduation	Year of full statistical elibility for graduation	Criteria satisfied	Year of CDP recommendation for graduation	Year of ECOSOC endorsement of the recommendaiton for graduation	General Assembly endosement of the recommendaiton for graduation [effective graduation date]
Botswana	1991	1994	Income, APQLI	1994	1994	1994 (res. 49/133 of 19 Dec.) [Dec. 1994]
Samoa	1991	1997	Income, APQLI	Not retained due to probable impact of ODA reduction		
	2003	2006	Income, HAI	2006	2007	2007 (res. 62/97 of 17 Dec.) 2010 (res. 64/295 of 7 Sep. - following 2009 tsunami) [Jan. 2014]
Cabo Verde	1994 (pre-eligibility not recognized)		Income, APQLI			
	1997 (pre-eligibility recognized)	1997 (full eligibility recognized)		2003	2004	2004 (res. 59/210 of 20 Dec.) [Dec. 2007]
Vanuatu	1994	1997	Income, APQLI	1997	1997	1997 (res. 52/210 of 18 Dec. postponed consideration of the case to the 2000 review, pending completion of vulnerability review)
	2006	2009	Income, HAI	2012	2012	2013 (res. 68/18 of 4 Dec. decided on graduation in Dec. 2017) 2015 (res. 70/78 of 9 Dec. deferred graduation to Dec. 2020)
Maldives	1997	2000	Income (both), EDI (1997), APQLI (2000)	2000	2004	2004 (res. 59/210 of 20 Dec.) 2005 (res. 60/33 of 30 Nov. deferred graduation to Jan. 2011) [Jan. 2011]
Kiribati	2003 (pre-eligibility not recognized)	2006	Income, HAI			
	2006, 2012 (pre-eligibility recognized)	2015		Decision on graduation deferred by the CDP to the 2018 review		
Tuvalu	2003 (pre-eligibility not rcognized) 2006 (pre-eligibility recognized)	2009 (CDP questioned "the sustainability of the present level of income" and did not recommend graduation)	Income, HAI	2012	ECOSOC did not take a decision on the case of Tuvalu unitl July 2015, when it decided to defer to 2018 its consideration of the recommendaoiton to graduate Tuvalu	
Equatorial Guinea	2006	2009	Income only	2009	2009	2015 (res.68/18 of 4 Dec. determines graduation in June 2017)
Angola	2012	2015	Income only	2015	2015	2016 (res.70/253 of 12 Feb. determined graduation in Feb. 2021)
Bhutan	2015		Income, HAI	If these countries meet the criteria for graduation once again at the time of the 2018 triennial review, they may be recommended by the CDP for graduation		
Nepal	2015		HAI, EVI			
Sao Tome and Principe	2015		Income, HAI			
Solomon Islands	2015		Income, HAI			
Timor-Leste	2015		Income only			

Source: UNCTAD secretariat elaboration, based on own research and on information from the following websites: http://www.un.org/en/development/desa/policy/cdp/ldc/ldc_data.shtml; http://unohrlls.org/about-ldcs/criteria-for-ldcs/ (accessed June 2016).

Note: APQLI: augmented physical quality of life index; ECOSOC: United Nations Economic and Social Council; EDI: economic development index; EVI: economic vulnerability index; HAI: human assets index.

(d) To evaluate the trajectories followed by LDCs likely to graduate based on two criteria vis-à-vis those graduating based on the income-only criterion;

(e) To examine the likely major features of the LDC group once the countries projected to graduate have left the category.

It should be emphasized that these projections are purely indicative and are made for analytical purposes only. They are not meant to prejudge the decisions

Table 2.2. Projected graduation cases, 2017–2024

Country	Year of **actual**/*projected* statistical pre-eligibility for graduation	Year of **actual**/*projected* full statistical elibility for graduation	Criteria satisfied	Year of **already decided**/*projected* graduation
Equatorial Guinea	**2006**	**2009**	Income only	**2017**
Vanuatu	**2006**	**2009**	Income, HAI	**2020**
Angola	**2012**	**2015**	Income only	**2021**
Bhutan	**2015**	*2018*	Income, HAI	*2021*
Kiribati[1]	**2006, 2012**	**2015**	Income, HAI	*2021*
Nepal	**2015**	*2018*	HAI, EVI	*2021*
Sao Tome and Principe	**2015**	*2018*	Income, HAI	*2021*
Solomon Islands	**2015**	*2018*	Income, HAI	*2021*
Timor-Leste	**2015**	*2018*	Income only	*2021*
Tuvalu[1]	**2006**	**2009**	Income, HAI	*2021*
Afghanistan[2]	*2018*	*2021*	HAI, EVI	*2024*
Bangladesh	*2018*	*2021*	Income, HAI, EVI	*2024*
Djibouti	*2018*	*2021*	Income, HAI, EVI	*2024*
Lao People's Democratic Republic	*2018*	*2021*	Income, EVI	*2024*
Myanmar	*2018*	*2021*	HAI, EVI	*2024*
Yemen[3]	*2018*	*2021*	HAI, EVI (2018); Income, HAI, EVI (2021)	*2024*

Source: UNCTAD secretariat elaboration. For the methodology and assumptions used for projections, see box 2.2.
Notes: For caveats regarding the interpretation of the results presented in this table, see the main text.
1 Although this country has already met the full statistical eligibility for graduation according to prevailing criteria, it is possible that the decision on its actual graduation will eventually be delayed, in view of its lingering vulnerability.
2 UNCTAD projections indicate the full statistical eligibility of this country for graduation according to prevailing criteria. However, it is possible that the decision on its actual graduation will eventually be delayed, in view of its lingering security concerns which can potentially have adverse effects on the three graduation criteria.
3 While UNCTAD projections indicate the full statistical eligibility of this country for graduation according to prevailing criteria, it is possible that the decision on its actual graduation will eventually be delayed, in view of its lingering security concerns, and of the steep (28 per cent) fall in GDP projected for 2015. This fall is fully taken into account in the Income forecasts, but not at all in the HAI and EVI projections. A prolonged military conflict is likely to have adverrse effects on the three graduation criteria.

either of LDCs themselves, or of the Committee for Development Policy (CDP), the United Nations Economic and Social Council (ECOSOC) or the United Nations General Assembly. As noted in chapter 1, the decisions of these States and organs concerning graduation do not follow mechanically from the statistical criteria, but rely also on other considerations. Such considerations are not taken into account in the projections used here, although some cases in which they are likely to modify a decision based purely on the statistical criteria (and hence the timing of graduation) are indicated in the notes to table 2.2. Cases of prolonged military conflict, for example, are likely to modify the graduation prospects of affected countries, but their potential impact has not been factored into the projections due to inherent uncertainties generated by these processes. Consequently, the actual graduation cases in the period analysed are likely to differ somewhat from those indicated here.

Sixteen LDCs are projected to graduate during 2017–2024.

The main results of this exercise are as follows.

- Sixteen LDCs are projected to graduate during the 2017–2024 period, including most of the Asian and island LDCs, but only three LDCs in Africa.
- Graduation may result from a broad-based process of development of productive capacities, structural transformation and diversification of the economic structure, in line with what this Report calls "graduation with momentum", as in the case of two manufactures exporters (Bangladesh and Bhutan) and two mixed exporters (the Lao People's Democratic Republic and Myanmar). However, this is by no means always the case.

- Almost half of the projected graduates are services exporters, indicating the significant role of services exports in progress towards graduation. These countries have diversified their exports into tourism (particularly the island LDCs, but also Nepal) or government services (Afghanistan and Djibouti). Diversification of exports towards services has an impact on the economic vulnerability index (EVI), but does not necessarily mean structural transformation of the economy.
- Fuel extraction is an important driver of graduation over the period. It tends to boost income growth, but this is not necessarily associated with commensurate human development or with economic diversification. Four fuel-exporting LDCs are projected to graduate (Angola, Equatorial Guinea, Timor-Leste[1] and Yemen), all based on the income-only criterion except for Yemen, which is projected to graduate based on two criteria.[2]
- Afghanistan, Myanmar and Nepal are projected to graduate on the basis of the HAI and the EVI. If this is the case, this will be the first time that the income criterion has not been met at the time of graduation.
- The IPoA target on graduation is interpreted here as meaning that half of the LDCs should achieve full statistical eligibility for graduation by 2020 (as explained in chapter 1). However, the UNCTAD projections indicate that this target is unlikely to be met, as only 10 LDCs are projected to be fully statistically eligible for graduation by that date, rather than the 24 targeted. Even in 2021, only 16 countries are projected to have achieved full statistical eligibility, still well below the IPoA target.

Only three projected graduates are in Africa, while almost half are services exporters.

The projections suggest that the IPoA target for graduation will not be met.

The different growth and development paths leading to graduation are of particular significance in the present context. Some LDCs are on course for a process of graduation with momentum, characterized by a broad-based process of development of productive capacities and structural economic transformation. However, other LDCs are projected to graduate without such a process. In some cases this occurs through enclave-led growth (especially in cases where growth is led by extractive industries). In others, particularly small economies, it occurs through investment in human development combined with a limited degree of export diversification, which push the HAI and EVI, respectively, beyond graduation thresholds. In neither case does graduation indicate that these countries have undergone structural transformation.

The possibility of countries graduating without being on the path to structural transformation indicates a need to reconsider the graduation criteria, so that they reflect more fully the long-term development processes that underpin graduation with momentum. This issue is further discussed in chapter 5. Meanwhile, under the current graduation criteria, it is of the utmost importance that the States and organs influencing or deciding the cases of graduation (LDCs themselves, the CDP, ECOSOC and the General Assembly) continue to take due account of factors other than the statistical eligibility for graduation. As can be seen in table 2.1, this has been the practice in graduation cases to date.

The projection results suggest a need to reconsider the graduation criteria to reflect "graduation with momentum".

It should be emphasized that the projections made here rely heavily on the methodology used and the assumptions made (box 2.1). Other projections, which apply different methodologies and assumptions, have obtained different results. Drabo and Guillaumont (2016) project that between 8 and 13 LDCs will meet the income-only graduation criterion in the 2021 review of the list of LDCs, depending on assumptions for the gross national income (GNI)/gross domestic product (GDP) growth rate. Kawamura (2014), in a paper published before the 2015 triennial review of the list of LDCs, projected that up to 11 countries would achieve full statistical eligibility for graduation by the 2021 triennial review.[3]

Box 2.1. Methodology for the projection of LDC graduation until 2024

The projection of the progress of individual LDCs towards graduation prepared by UNCTAD for this Report is based on the assumptions and methods detailed below. The first set of assumptions, related to the graduation process, was as follows.

- In cases where the United Nations General Assembly has endorsed the recommendation made by ECOSOC, graduation will take place on the date that has already been decided.
- Once a country has achieved full statistical eligibility for graduation, the CDP will make a recommendation for graduation, which will be endorsed by ECOSOC. The United Nations General Assembly will then endorse the recommendation and set a uniform grace period of three years.
- There will be no cases of addition to the list of LDCs during the period, only of graduation out of the category.

The second set of assumptions refers to the projections of GNI per capita, the HAI and the EVI for each country.

The GNI per capita of each LDC at the triennial reviews of 2018 and 2021 was estimated by applying the forecast growth of the GDP of the country concerned for the period between successive reviews to the level of the GNI per capita at the 2015 review. It is thus assumed that the GNI/GDP ratio of each LDC will remain the same throughout the forecast period. The forecast GDP growth rates are taken from the International Monetary Fund's World Economic Outlook database (April 2016 edition).[4] It is also assumed that the CDP will follow the standard practice of using data with a two-year lag. Projections for the 2018 review, for example, were based on GNI per capita for the 2014–2016 period. Given the current very low inflation rate internationally, the income thresholds for graduation for 2015 were assumed to apply in both the 2018 and the 2021 revision (that is, no corrections for inflation were made either to the thresholds or to projected GNI per capita).

The 2018 and 2021 values of the HAI and EVI for each country were projected on the basis of the 2015 values, by applying the logarithmic trend derived from the levels of the indices used in the revisions of 2006, 2009, 2012 and 2015. Following CDP practice, the thresholds for graduation for 2018 and 2021 were assumed to remain at the levels set in 2012.

C. The role of geographical factors in graduation performance

1. The landlocked developing country factor

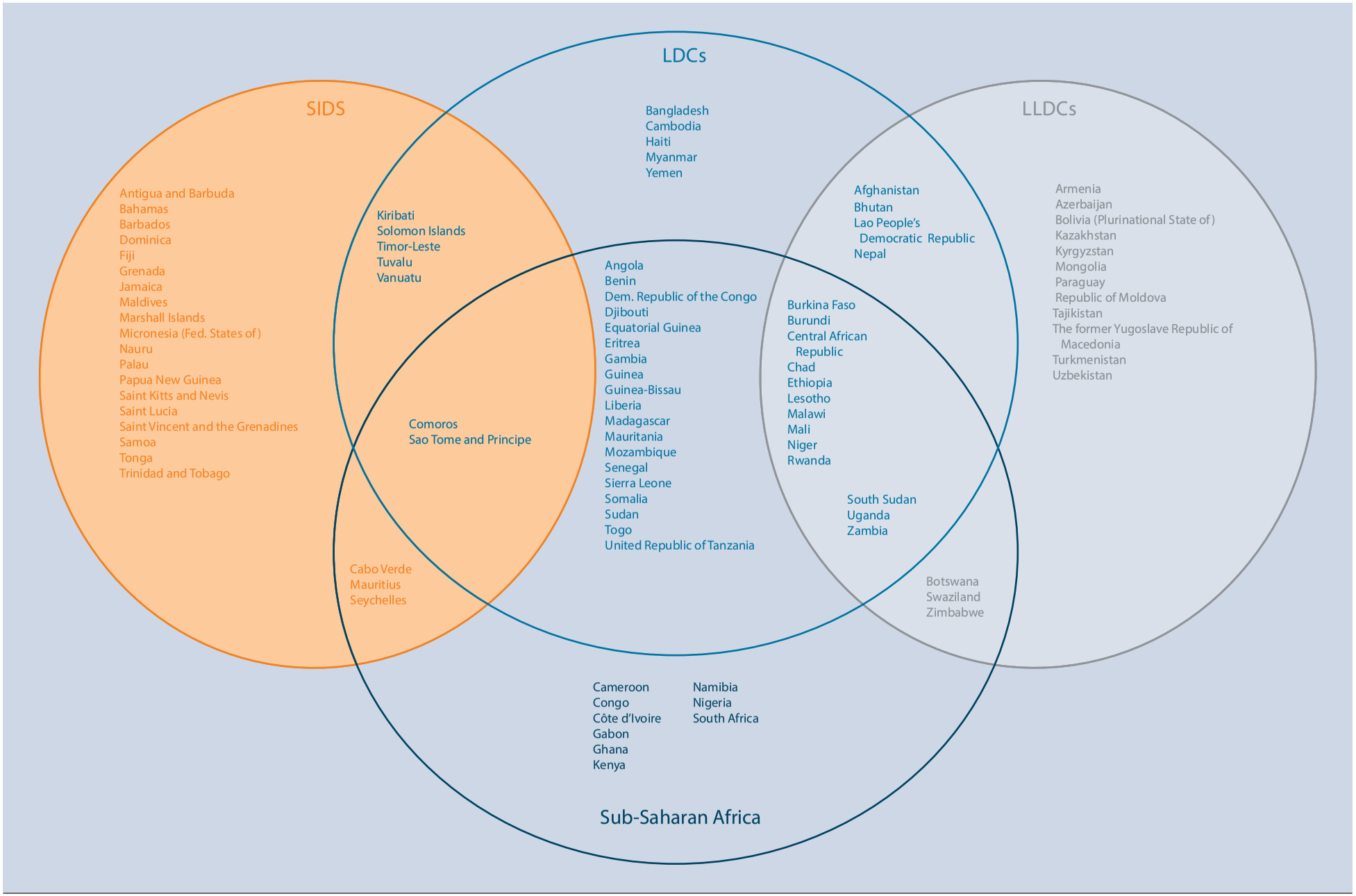
Only one landlocked country has graduated, and only four are projected to graduate by 2024, all in Asia.

There is a significant relationship between LDC status and a landlocked geographical location: more than 40 per cent of the LDCs are landlocked (20 of 48); and these 20 LDCs represent almost two thirds of the 32 landlocked developing countries (LLDCs) (figure 2.1). There is also a relationship with graduation: although the first LDC to graduate in 1994 was an LLDC (Botswana), no LLDC has graduated since; and of the 16 countries projected to graduate by 2025, only four — all in Asia — are landlocked (Afghanistan, Bhutan, the Lao People's Democratic Republic and Nepal) (table 2.2).

The Vienna Programme of Action for Landlocked Developing Countries for the Decade 2014–2024 highlights the special challenges faced by LLDCs, which (United Nations, 2014a, para. 1):

> are associated with their lack of direct territorial access to the sea, remoteness and isolation from world markets. Their international trade depends on transit through other countries. Additional border crossings and the long distance from major markets, coupled with cumbersome transit procedures and inadequate infrastructure, substantially increase the total expenses for transport and other transaction costs, which erodes the competitive edge of landlocked developing countries, reduces economic growth and subsequently negatively affects their capacity to promote sustained economic development, human and social progress and environmental sustainability.

Figure 2.1. Country groups: LDCs, LLDCs, SIDS, and sub-Saharan African countries



Note: While sub-Saharan African is a geographical group, rather than a category recognized by the United Nations, it is singled out here because the vast majority of its countries belong to these categories (which is not the case for other regions).

Landlocked LDCs face additional challenges compared with other LDCs...

Beyond the structural problems common to LDCs (such as those discussed in chapter 1), landlocked LDCs face some additional challenges, especially high trade transaction costs, lack of export competitiveness, overdependence on official development assistance (ODA), high external debt, inadequate foreign reserves, and reliance on migrants' remittances. A further challenge specific to LLDCs is their dependence on the economic, political and environmental situation of neighbouring countries, particularly transit countries for their foreign trade. If these are large and dynamic economies, then they can provide a boost to the economic growth of LLDCs (Paudel, 2014). All four landlocked LDCs projected to graduate by 2024, as well as the one LLDC which has graduated to date (Botswana), share borders with large (non-LDC) developing economies, which in most cases have experienced relatively rapid growth.

... but these challenges are more limited for countries neighbouring large and dynamic economies.

The development of landlocked LDCs can, however, be hampered if their neighbouring countries suffer from poverty, slow economic growth, political instability and/or vulnerability to natural shocks. The dependence of LLDCs on, and their close economic ties with, their neighbours makes them vulnerable to external (economic and environmental) shocks and social and political instability affecting neighbouring countries, as well as those impacting them directly (UN-OHRLLS, 2014). The transit neighbours of African landlocked LDCs, in particular, in most cases have broadly similar economic structures and are beset by similar scarcity of resources to the landlocked LDCs themselves, seriously limiting the potential for exploitation of economic complementarities.

Most economic studies that have analysed the impact of a landlocked position on economic growth have found that lack of direct access to the sea represents a constraint to economic growth (Collier and Gunning, 1999; Dollar and Kraay, 2003; Friberg and Tinn, 2009). Controlling for other determinants, the growth rate of landlocked countries has on average been found to be at least 3½ percentage points below that of other countries; and this effect cannot be entirely offset even by domestic policies conducive to growth (Paudel, 2014).

Landlocked LDCs tend to have lower GNI per capita and more limited human development.

Landlocked LDCs also perform less well than other subgroups of developing countries (including other LDCs) in terms of income and human capital development. Landlocked LDCs are poorer than other LDCs, with an average GNI per capita more than one quarter less than the LDC average and 37 per cent less than that of other (coastal and island) LDCs (figure 2.2). Landlocked LDCs on average also have a lower HAI than other LDCs (45.7 compared with 54.7), though by a smaller margin (figure 2.3).

The relative performance of landlocked LDCs is better in relation to the EVI. Their average of 39.3 compares with 42.6 for non-landlocked LDCs (figure 2.3) and 52.0 for SIDS LDCs (figure 2.4), but is well above the graduation threshold of 32.0 (a lower figure indicating lower vulnerability). However, this partly reflects the inclusion in the EVI of the share of population in low-lying coastal zones, which is by definition zero in LLDCs.

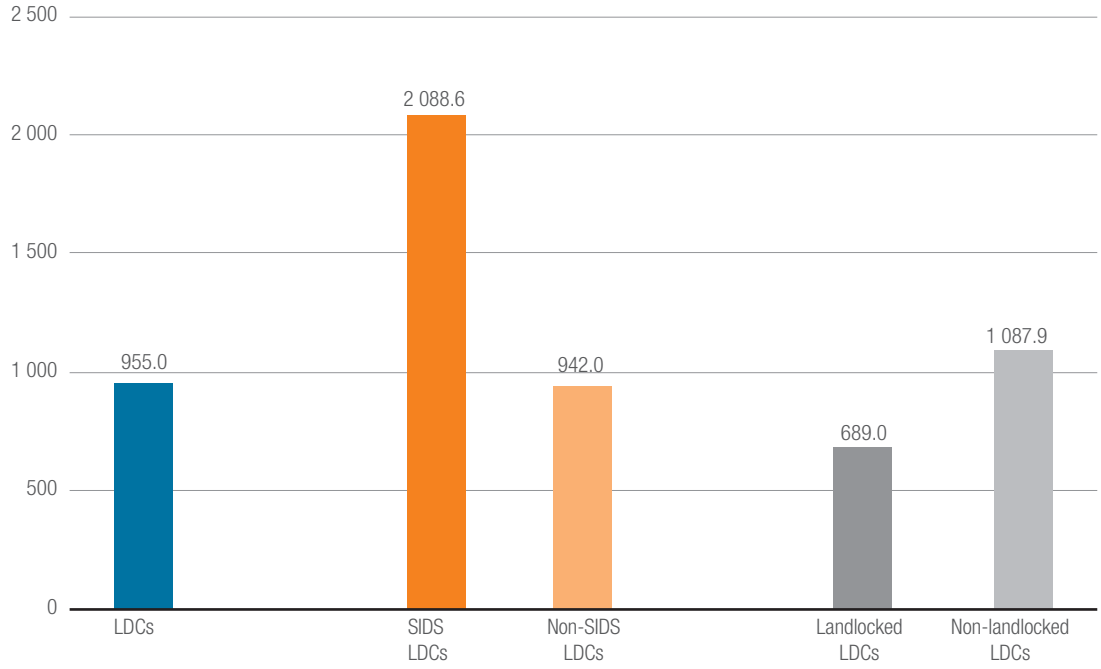
The challenges to graduation of being landlocked are not insurmountable if the right policies are implemented.

In light of the challenges outlined above, it is not surprising that graduation of landlocked LDCs is projected to remain limited for the foreseeable future. While four landlocked LDCs are projected to graduate by 2024, it should again be emphasized that all these countries share borders with relatively large and growing ODC economies.

2. The small island developing State factor

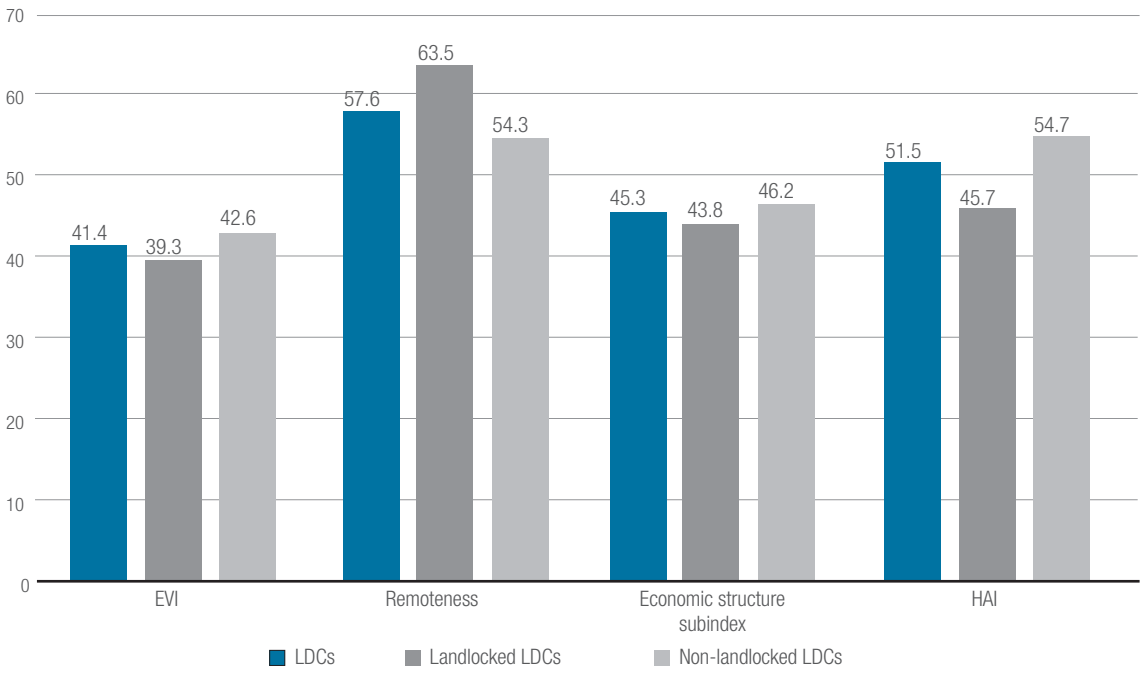
Seven countries are currently classified as both LDCs and as SIDS:[5] the Comoros, Kiribati, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu (figure 2.1). In contrast to landlocked LDCs, SIDS LDCs

Figure 2.2. Gross national income per capita of LDCs and subgroups, 2013–2015



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed September 2016); United Nations, National Accounts Main Aggregates database for Djibouti, Eritrea, Myanmar, Somalia, and Yemen (accessed September 2016).
Notes: Aggregates are weighted averages.
Average 2012–2014 for the Comoros, Djibouti, Eritrea, the Gambia, Lesotho, Mauritania, Myanmar, Sao Tome and Principe, Somalia, Tuvalu, Vanuatu and Yemen.

Figure 2.3. Selected structural indicators of landlocked LDCs



Source: UNCTAD secretariat calculations, based on data from the CDP Secretariat prepared for the 2015 triennial revision of the list of LDCs.
Note: Aggregates are simple averages. EVI: economic vulnerability index; HAI: human assets index.

have performed remarkably well in terms of graduation, and are expected to continue to do so. Three of the four countries that have graduated to date are SIDS, as are the majority (6 of 10) of those projected to graduate by 2021. This means that all but one of the seven current island LDCs (the Comoros) are expected to graduate by that date.

Despite their good graduation performance, however, SIDS LDCs are faced with an apparent "double structural handicap", since they combine the challenges and vulnerabilities of LDCs and those of SIDS. The major challenges facing SIDS include their small size, their remoteness from large markets, the limited scope for economies of scale resulting from the interaction of these two features, and their particularly acute economic vulnerability to external economic and natural shocks.

Small-island LDCs have performed remarkably well in terms of graduation…

The significant overlap between the development challenges faced by SIDS and those faced by LDCs are reflected in both the IPoA and the SIDS Accelerated Modalities of Action (SAMOA) Pathway.[6] These include:

- Limited productive capacities, which in turn inhibit economic diversification, international competitiveness, diversification of trading partners and integration into the world economy;
- The threat of climate change, extreme weather events and natural disasters;
- Widespread and acute infrastructural deficits, notably in transportation, power generation (including sustainable energy), water, sanitation, and information and communications technology (ICT);
- Lack of food and nutritional security, often coupled with heavy dependence on food imports;
- Weak domestic resource mobilization and external debt sustainability.

As a result of their small economic size, SIDS economies also tend to be particularly dependent on international trade and financial flows, and thus more exposed to exogenous shocks.

Various models have been developed to explain the structure and dynamics of their economies, which condition the development strategies that are available to them (box 2.2).

…despite their structural disadvantages and greater economic and environmental vulnerability.

Beyond the economic and environmental challenges common to all LDCs, SIDS LDCs have several distinguishing features. First, they have particularly acute economic vulnerability, with a higher EVI (52.0) than non-SIDS LDCs (39.6) (figure 2.4). Kiribati has the highest EVI score of the 145 countries for which the CDP has calculated this index. Of the 20 countries with the highest EVI scores, 13 are SIDS (4 of them LDCs), while 5 are non-SIDS LDCs and only 2 fall into neither category. This shows that vulnerability is particularly high in both SIDS and LDCs.

There are four major reasons for the particular vulnerability of SIDS LDCs.

- They are more remote from larger economies than other LDCs, scoring 71.2 on the remoteness index compared with 55.2 for non-SIDS LDCs (figure 2.4).
- Their domestic markets are much smaller, weakening their competitiveness by limiting the potential for economies of scale, while increasing their reliance on export markets, and thus intensifying their exposure to the vagaries of international markets and their vulnerability to global economic crises.
- Their economic structures are weaker than either other LDCs or other SIDS, with greater export concentration and less diversified markets, increasing

Box 2.2. The MIRAB, PROFIT and SITE models for small island economies

The special economic needs and situations of small island economies started to be addressed in the social sciences literature in the 1960s. Some early island scholars, building on the work of authors such as Robinson (1960), emphasized the disadvantages of small island economies in terms of "a narrow production base, macroeconomic vulnerability to trade fluctuations, high administrative costs and a tendency towards monopolistic markets". Others, such as Kuznets, by contrast, stressed the advantages of small island economies in terms of their rich social capital (solidarity, social cohesion and sense of community) and their ability to adjust painlessly and continuously to changing economic circumstances (Oberst and McElroy, 2007).

In the 1980s, Bertram and Watters (1985) developed the MIRAB model as a characterization of several island economies in the Pacific, also applicable to some other small island economies. MIRAB is an acronym for migration (MI), remittances (R), foreign aid (A) and public bureaucracy (B). Essentially, the model posits that micro-States in the Pacific depend on these four elements to sustain the standard of living of their populations in the face of apparently limited domestic economic production and a small private sector characterized by slow growth (Oberst and McElroy, 2007; Tisdell, 2014).

The MIRAB model dominated the literature for almost two decades, until the development of the PROFIT and SITE models. The PROFIT model (Baldacchino, 2006) highlights development based on people (that is, emigration) (P), resources (R), overseas management (that is, diplomacy) (O), finance (F) and transport (T). What distinguishes PROFIT economies from MIRAB economies is their active use of domestic policy, the dynamism of their private sector and strategic orientation towards diversification (Oberst and McElroy, 2007:165). McElroy (2006) considered small (warm-water) island tourist economies (SITE), often linked with export processing zones and offshore banking centres, as a subcategory of the PROFIT genre. On this basis, Oberst and McElroy (2007) proposed a classification of small islands as either MIRAB or PROFIT-SITE types, shown for SIDS in box table 2.1.

According to their exercise, the seven current SIDS LDCs (the Comoros, Kiribati, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu) are all MIRAB economies, as are two of the three SIDS that have graduated from the LDC category (Cabo Verde and Samoa). The other SIDS graduate (Maldives) is classified as a PROFIT-SITE. However, the classification of some SIDS LDCs and SIDS graduates as MIRAB economies may be affected by recent changes in their economic circumstances: Cabo Verde, for example, is now clearly in the SITE category, given the extent of the relatively recent development of its tourism industry.

Box table 2.1. Classification of island economies according to the MIRAB and PROFIT-SITE models

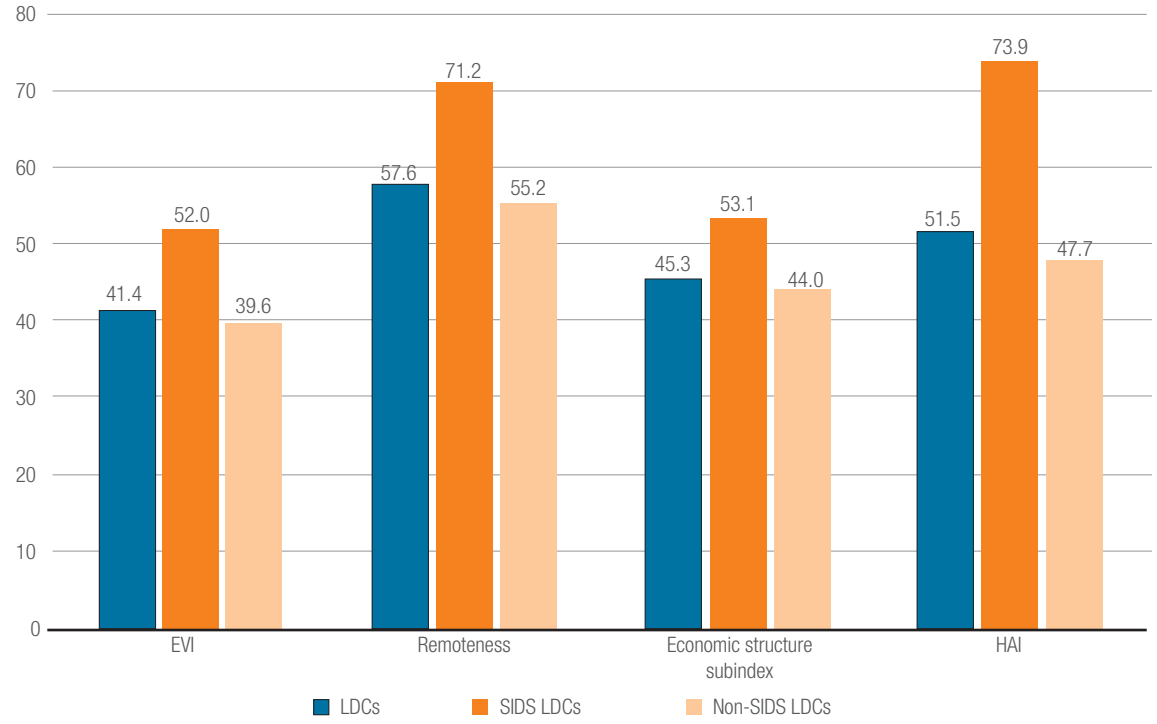
MIRAB	PROFIT-SITE
Cabo Verde	Antigua and Barbuda
Comoros	Bahamas
Dominica	Barbados
Kiribati	Fiji
Marshall Islands	Grenada
Federated States of Micronesia	Jamaica
Nauru	Maldives
Samoa	Mauritius
Sao Tome and Principe	Palau
Solomon Islands	Saint Kitts and Nevis
Timor-Leste	Saint Lucia
Tonga	Saint Vincent and Grenadines
Tuvalu	Seychelles
Vanuatu	Trinidad and Tobago

Source: UNCTAD secretariat, based on Oberst and McElroy (2007), and on the UNCTAD list of SIDS.
Note: For the meaning of the models, see the box text.

their exposure to trade shocks. None of the SIDS LDCs has a developed export base for manufactured goods.

- SIDS LDCs are also particularly vulnerable environmentally. Overall, 34.3 per cent of their population lives in coastal zones with low elevation, compared with 20.4 per cent for non-LDC SIDS, and only 3.9 per cent for non-SIDS LDCs.

Figure 2.4. Selected structural indicators of SIDS LDCs



Source: UNCTAD secretariat calculations, based on data from the secretariat of the CDP prepared for the 2015 triennial revision of the list of LDCs.
Note: Aggregates are simple averages. EVI: economic vulnerability index; HAI: human assets index.

Vulnerability leaves small-island LDCs particularly dependent on ODA and debt relief.

A second distinguishing feature of SIDS LDCs lies in their particularly heavy dependence on ODA and debt relief. Their external financing gaps need to be filled through a combination of ODA, borrowing and other external resources such as workers' remittances. SIDS LDCs' net ODA receipts per capita in 2014 ranged from $96 (in the Comoros) to $3,480 (in Tuvalu), compared with an LDC average of $47 per capita.

SIDS LDCs also have substantially better human asset endowments and higher per-capita incomes on average than do non-SIDS LDCs, a reflection of the so-called "island paradox". On average, SIDS LDCs score 73.9 on the HAI, compared with only 47.7 for non-SIDS LDCs (figure 2.4). The average GNI per capita of SIDS LDCs was $2,088.6 in 2013–2015, more than double that of other LDCs ($942) (figure 2.2).

Higher incomes and human development allow island LDCs to graduate more readily than others.

Because LDCs can graduate by reaching the threshold levels of GNI per capita and HAI alone, the advantages of island LDCs on these two indicators are sufficient to outweigh their multiple disadvantages in terms of vulnerability. All three of the historical cases of SIDS graduation were based on income per capita and the HAI (or its predecessor, the augmented physical quality of life index), as are five of the six cases projected up to 2024. The one exception, Timor-Leste, is projected to graduate on the basis of the income-only criterion.[7] Thus, while several landlocked LDCs are prevented from graduating in the medium term by low incomes and relatively weak HAIs, the higher income per capita and HAI characteristic of most SIDS LDCs allows them to graduate more readily than other LDCs, despite their much greater vulnerability as measured by the EVI.

D. National processes leading to graduation

Notwithstanding the underdevelopment "traps" outlined in chapter 1 and the geographical challenges described in section C above, the success of some LDCs in graduating, and the progress of many others towards graduation, demonstrates that these do not represent insurmountable obstacles to graduation. Overcoming (or at least mitigating) these obstacles is a defining objective of ISMs; but national policies, strategies, mechanisms and measures are also critical, to overcome these structural handicaps and unlock LDCs' development potential. This section discusses the national strategies that enabled those countries that have graduated to date to do so, and the graduation strategies of the current LDCs.

National policies and strategies are critical to overcome LDCs' structural handicaps.

1. Strategies of the graduates to date

One of the commonalities of the strategies that led Botswana, Cabo Verde, Maldives and Samoa to graduation from the LDC category is that none of them had articulated policies specifically aimed at graduation. Rather, each Government pursued national, regional and international policies directed towards broader development objectives, and graduation occurred as an indirect result. Elements that contributed to their success included, in varying degrees, macroeconomic stability; support to productive investment; good governance; investment in health and education; and strategic use of each country's endowments, advantages and opportunities to support a broadly based development process.

None of the countries that have graduated to date has had an explicit graduation strategy.

(a) Botswana

A critical factor in the success of Botswana's development policies has been the quality and nature of its governance, based on a mixture of Tswana traditions and customs with the Romano-Dutch and British system adopted at independence. During the 23 years that Botswana remained an LDC, the following national policies made an important contribution to its graduation from the category in 1994 (Mogae, 2016).

Economic and social planning: Ever since its independence in 1966, the Government of Botswana has issued five-year National Development Plans (NDP). These were, in effect, rolling plans, overlapping if circumstances required them to be modified. Since the beginning of NDP 1, which ran from 1968 until 1973, the Government has focused its development efforts on raising the standard of living of all Botswanans. Poverty alleviation and the provision of basic infrastructure and social services have thus served as the bedrock of development policy. Each plan included both economic and social goals, which were considered to be inseparable. The planning process was designed to ensure the maximum possible gain from the limited financial resources available to the Government through prioritization of policies, programmes and projects. It also allowed the Government to set goals and objectives against which its performance could be objectively evaluated. The Government also engaged proactively in aid management and donor coordination, requiring development partners to direct their funds to those projects classified as national priorities in the plan.

Economic and social planning helped Botswana achieve graduation.

Between 1966 and 1974, Botswana was one of the fastest growing economies in the world. Real GDP growth averaged 16 per cent between 1970 and 1974, and remained in high single figures until 1989. Following the discovery of diamonds in 1967, and the subsequent adoption of an explicit

industrial policy to promote private-sector-oriented development of the mineral sector, mining became (as it remains) the leading economic sector of Botswana, surpassing agriculture since 1977/78. The ratio of government revenue to GDP averaged 50 per cent (peaking at some 64 per cent in 1988), allowing a fiscal surplus. Domestic savings started to exceed investment and the trade account also generated a surplus.

The vesting of mineral rights in the State and an effective mineral taxation policy played a central role.

Harnessing mineral resources for development: Ever since independence, mineral rights have been vested in the central Government, allowing the Government effective control when diamonds were discovered. This was critical to the establishment of the authority of the State and provided a guaranteed source of government revenue. An effective mineral taxation policy was put in place under which the State charged a modest fixed royalty rate and took an equity stake in the mining company, ensuring a share of the future profits of mining operations. When De Beers discovered diamonds, the Government initially took a 15 per cent stake in the diamond mines, but renegotiated the contract as the true scale and value of the diamond deposits became apparent (Hazleton, 2002). The De Beers Botswana Mining Company (Proprietary) Limited was created and now (renamed Debswana), is jointly owned by De Beers and the Government of Botswana as equal partners. The creation of a sovereign wealth fund (the Pula Fund) in 1994 has allowed the Government both to save a portion of the income from diamond exports for future generations and to use the resources generated to fund promotion of economic diversification.

Diamond exports made Botswana's landlocked position less problematic.

Developing transport corridors and good infrastructure: As a landlocked country, Botswana is critically dependent on its transit neighbours' transport infrastructure to move goods to and from ports. Diamond exports provided an important advantage in this respect, as their high value-to-volume ratio allows them to be transported economically by air. The creation of an efficient transport corridor through South Africa has further reduced the impact of Botswana's landlocked position by reducing trade costs for other goods; and the Government has invested in other regional corridors, notably with Namibia and Mozambique. It has also focused on improving its domestic infrastructure, particularly for road and air transport, to facilitate trade and attract investors.

Improving education: To achieve basic education for all and address skilled labour and human capital shortages, Botswana devoted an increasing share of its budget to education, raising it from 15 per cent in the 1970s to more than 20 per cent in the 1990s. School fees were abolished; and school enrolment rates have risen considerably at all levels. To facilitate the transfer of skills, knowledge and experience, localization exercises were implemented in both the public and private sectors, through which expatriates mentored suitably qualified Botswana counterparts to ensure adequate training.

(b) Cabo Verde

Like Botswana, Cabo Verde has enjoyed peace and political stability since its independence in 1975, with a vibrant multiparty democracy, credible institutions and relatively good governance. Its development strategies have emphasized the following features (Resende dos Santos, 2016).

Cabo Verde has maximized the development impact of external resources…

Prudent and forward-looking macroeconomic management: Lacking both exploitable mineral resources and an adequate size for economic self-sufficiency, Cabo Verde has ably managed its vulnerability, while maximizing the developmental impact of external resources (primarily ODA and remittances). State modernization, especially in the area of public financial management, has substantially strengthened the country's macroeconomic management capacity; and the introduction of an integrated system for budget and financial management in 2002 contributed to improvements in both revenue

collection and national planning. The Government also introduced a forward-looking strategy to improve rural infrastructure, financing labour-intensive rural development projects with the proceeds of domestic sales of food aid, thereby also generating employment and reducing rural poverty.

State-driven policies with private support: The Government also invested in major social infrastructure projects, including water supply, sanitation, public health systems and schools, as well as in economic infrastructure, which has made a major contribution to growth and employment creation. About 90 per cent of all public investment has been financed by ODA (including concessional borrowing) since the 1980s, when it represented the largest share of domestic expenditure. Combined with a reduction in the rate of corporate taxation, these investments also encouraged foreign direct investment (FDI) inflows. Opening the economy to the private sector, including through the privatization of State enterprises in telecommunications, water, energy, and banking, also contributed to growth. The creation of special emigrant savings accounts in the national banking system helped to increase private investment and domestic credit, allowing remittances to become an important source of domestic private investment and spurring growth in various industries and construction activities. By 1996, these measures had increased the share of the private sector in total investment to more than 50 per cent.

…financing 90 per cent of public investment with ODA.

Developing tourism: With limited scope for either agricultural or industrial development, Cabo Verde has been a services-based economy. The tertiary sector has generated most of the economic growth experienced since 1990, essentially due to the strong performance of tourism, which has also fuelled the growth of transport, construction, banking and insurance.

Tourism has been an important driver of economic growth in Cabo Verde.

Improving education and health: The Government devoted substantial resources, amounting to around 10 per cent of GDP, to healthcare and education. This has allowed the achievement of free, universal and compulsory schooling for at least six years.

(c) Maldives

Strategies adopted by the Government of Maldives that contributed to the country's graduation from the LDC category in 2011 include the following (Lui, 2016).

In Maldives, tourism was also a key pillar of development …

Developing tourism-led growth: During the 1980s and 1990s, the Government invested heavily in tourism-related construction, transport and communication, and attracted investments in resort development. This led to employment creation and high GDP growth rates, resulting in tourism overtaking fisheries as the largest sector in 1985 and contributing more than two thirds of GDP by 2013. The growth of tourism has been driven in part by the foreign private sector, with the support of government incentives and strategies, and facilitated by the absence of taxes and low rents. In 1983, the First Tourism Master Plan laid the foundations for the sustainable development of tourism and its integration into the social and economic development of the country, including the establishment of regulations governing the quality of services and facilities provided to tourists (Kundur, 2012). However, the narrow economic base arising from this heavy concentration on tourism leaves the economy vulnerable to external shocks, particularly the vagaries of international travel trends.

…and it became more important than fisheries.

Reviving the fisheries sector: Fisheries have been the traditional mainstay of the Maldivian economy. The Government has modernized the previously informal fishing sector to include more advanced and efficient techniques. The Marine Zones of Maldives Act No. 6/96, which took effect on 27 June 1996, specified a 12-mile territorial sea, a 24-mile contiguous zone and a 200-mile

exclusive economic zone (United States Department of State, 2005). The number of vessels operating in the exclusive economic zone was subsequently increased by opening it to foreign as well as domestic investors.

Prudent macroeconomic and fiscal policy: The Maldives' economic growth was at times sustained by proactive use of macroeconomic policies. During the early 1990s, for example, economic growth slowed partly as a result of the sharp decline in tourist arrivals due to a recession in Europe and the Gulf War, and partly as a result of reduced world tuna prices. This led to severe macroeconomic imbalances, including large fiscal deficits and strong pressure on the balance of payments. However, the increase in fiscal deficits was reversed by measures to enhance revenue and reduce expenditure (including on wages and salaries), cutting the deficit from around 10 per cent of GDP between 1990 and 1993 to less than 5 per cent from the late 1990s until 2004. This allowed Maldives' strong growth performance of the 1980s to be maintained during the 1990s.

Strengthening education and health services was a major priority.

Strengthening education and health services: The Government devoted considerable effort to meeting the learning needs of both children and adults. Its educational strategies were designed to facilitate access to employment and self-employment opportunities, and proved very effective in achieving universal access to basic education. Health outcomes were also improved considerably as a result of devoting 10 per cent of the government budget to health, including improvements to services and infrastructure. Child mortality fell from 48 per 1,000 live births in 1990 to 13 per 1,000 live births in 2010, while life expectancy at birth has increased from 63.5 years to 72.6 years for males and 74.4 years for females.

In Samoa, agricultural diversification and upgrading played an important role, as did tourism.

Labour policy and migrant labour: To help meet the needs of investors, the Government has allowed foreign labour to supplement the domestic labour force in sectors such as tourism. During Maldives' third phase of tourism development, between 1989 and 1997, the Government addressed the local labour shortages faced by the tourist industry by allowing immigration of foreign workers and exercising flexibility in the application of domestic regulations. By the end of 2006, 11,095 of the 22,000 jobs in the tourism sector were filled by expatriates, despite a limit of 50 per cent on the proportion of expatriates among total employees in tourist resorts (Kundur, 2012).

(d) Samoa

Samoa's graduation from the LDC category in 2014 was achieved through the Strategies for the Development of Samoa (2002–2004, 2005–2007, 2008–2012),[8] which were based on the following key pillars (Enari, 2016).

Policies were aimed at creating an enabling environment, promoting health and education, and improving disaster preparedness.

Agricultural upgrading and diversification: Two thirds of households are engaged in agriculture, which remains the backbone of the Samoan economy. An agricultural diversification strategy sought to combine production for local consumption, to improve food security, with commercial investment (including investment large-scale farming) to improve crop production, fisheries, livestock and forestry development. Investment was promoted in new high-value crops (vanilla, pepper and nonu), as were the processing of existing products and diversification into niche markets, notably organic production (for example, of virgin coconut oil, bananas and nonu products). Government measures to support diversification included strengthening research and extension services for product development, a Tuna Management Plan, and investment in supportive infrastructure, such as cooling facilities.

Promoting tourism: The Government also stimulated tourism development, in particular through the development of the necessary infrastructure and proactive marketing of Samoa as a destination, emphasizing Samoan culture and

traditions. FDI and domestic investment were encouraged in hotel development, and a Land Leasing Committee for tourism investment was created to negotiate with landowners and investors to maximize their benefits, reflecting the scarcity and high value of land.

Strengthening the private sector: The Government sought to create an enabling environment for private sector development, and promoted investment in areas where Samoa had a comparative advantage. Investment policy was supported by an accommodative fiscal policy stance and improvements to utility services and infrastructure, notably electricity and water supply, information and communication technologies (ICTs) and transport. Investment promotion policies were implemented to reduce transaction costs, rationalize charges, and provide financial and other incentives for the development of small businesses in rural areas. The Government also implemented a number of initiatives to facilitate the supply of credit.

Improving education and health services: An important objective has been the improvement of educational levels and health provision for the average Samoan, in part by strengthening the role of communities in supporting education. The Government has also acted to improve health through preventive health programmes and improvements to health facilities.

Most of the countries projected to graduate by 2024 have adopted graduation as an explicit goal…

Disaster preparedness and environmental sustainability: Environmental considerations, including climate change and disaster management, have featured prominently as a cross-cutting consideration in all planning activities. The Government has also increased expenditure for recovery and reconstruction following external shocks such as tsunamis, cyclones and financial crises.

Emigration has also played a significant role in Samoa's development and graduation, both by easing pressure on domestic employment, education and health services, and by generating remittances, which represented 20 per cent of GDP in 2015.

2. Strategies, plans and policies of current least developed countries

This section provides a non-exhaustive review of national strategies and priorities in LDCs, from a perspective of the structural transformation required to achieve graduation with momentum. In terms of the graduation criteria, the primary focus of national governments is typically economic growth, which impacts the income criterion directly, while having secondary effects on the EVI (especially in terms of export instability and the structure of GDP)[9] and the HAI.

…while most LDCs projected to graduate later have goals related to income.

(a) National goals: Graduation versus income classification

Most of the countries whose graduation is expected by 2024 have included graduation as an explicit goal in their development plans and programmes, and five of these countries (Bangladesh, Bhutan, the Lao People's Democratic Republic, Myanmar and Nepal) have set explicit timetables (United Nations, 2015b). Bhutan's eleventh Five Year Plan (2013–2018), for example, establishes graduation by 2020 as a top priority, while Nepal's Thirteenth Plan includes a target of graduation by 2022 (brought forward from 2030 in the Twelfth Plan in light of the IPoA graduation target).

In some cases, this includes an explicit focus on attainment of the graduation criteria themselves. In Nepal, the National Planning Commission's approach paper on graduation by 2022 includes "strategic directions and actions" for each of the three criteria as well as for monitoring and evaluation (Nepal,

National Planning Commission, 2014). Bangladesh is focusing primarily on the HAI criterion, as it has already fulfilled the EVI criterion and remains far below the graduation threshold for GNI. Here, civil society has been active in discussing the prospects for and policies towards graduation, led by the Centre for Policy Dialogue, a local think tank.

Many LDCs have adopted sectoral and industrial policies to promote structural transformation.

Some of the countries approaching graduation have also established institutions to support and oversee the process. Myanmar, for example, has established a high-level committee on graduation headed by the Vice-President, and specific subcommittees for each of the graduation criteria. The Government of Angola (scheduled to graduate in 2021) has also set up a high-level committee to oversee the graduation process.

Most LDCs that are not expected to graduate until after 2024, by contrast, emphasize goals related to income classifications, rather than graduation from LDC status. Such aspirations are expressed, for example, in the national development plans of Ethiopia, Rwanda, Uganda, the United Republic of Tanzania and Zambia. The aim of Ethiopia's Growth and Transformation Plan is to take the country to middle-income status[10] between 2020 and 2025; Zambia's National Vision is to become "a prosperous middle-income nation by 2030"; and both Rwanda's Second Economic Development and Poverty Reduction Strategy and Uganda's Second National Development Plan set a goal of achieving middle-income status by 2020. For Senegal, the Plan Sénégal Emergent aims to make Senegal an "emerging" country by 2035, while Cambodia's Rectangular Strategy Phase Three aims "at graduating from a low-income country to a lower-middle-income status in the very near future and further to become an upper-middle income country by 2030".

Energy and transportation are particular priorities, both within countries and regionally.

(b) Laying the foundations for structural transformation

Structural transformation of the economy entails increasing productivity within sectors, and shifting productive resources from lower- to higher-productivity sectors and activities. The poverty-oriented structural transformation needed to attain the Sustainable Development Goals requires increasing labour productivity to be accompanied by increasing employment, particularly in a context of high underemployment and a rapidly expanding workforce due to past reductions in child mortality rates outpacing reductions in birth rates (UNCTAD, 2015a). LDCs have adopted a series of sectoral and industrial policies directed towards these ends, some of which are reviewed below.

Several LDCs have recently implemented tax system reforms to strengthen domestic resource mobilization.

The energy sector is of particular importance to structural transformation, particularly where access to modern energy sources is limited. In African LDCs particularly, falling costs for small-scale renewable energy offer a major opportunity for the transformation of rural economies (UNCTAD, 2014: box 5). A number of LDCs report new and ongoing energy projects to exploit renewable energy potential, though mostly on a larger scale. For example, completion of the Grand Renaissance Dam on the Nile in 2017 is expected to quadruple Ethiopia's power generation capacity, while the Democratic Republic of the Congo has a number of hydropower initiatives and is considering solar and wind alternatives (UNECA, 2016). A new utility-scale solar energy project in Zambia has the lowest price yet recorded for such a project in Africa (Pothecary, 2016). Outside the renewables sector, the Hongsa Power Company lignite power plant located in the Lao People's Democratic Republic is aimed at removing domestic bottlenecks in energy supply, as well as generating export revenues through sales to Thailand.

Improved transportation also contributes to structural transformation, notably by reducing costs along the supply chain. In Ethiopia, the road network doubled between 1997 and 2011. Road rehabilitation can also have a major impact on

transport costs, for example reducing transport costs over a 17–20 kilometre route in Rwanda by two thirds between 1999–2000 and 2009–2010 (Lunogelo and Baregu, 2014).

Regional initiatives are particularly important in transportation, especially for LLDCs. The Lao People's Democratic Republic and Nepal aspire to become "landlinked" rather than "landlocked" by addressing their transportation problems. An initiative to build a new East Africa railway connecting Burundi, Kenya, Rwanda, South Sudan and Uganda was launched in 2014. Other new initiatives include railways connecting Ethiopia and Djibouti, and linking Bhutan and Nepal with China and India. The Benguela railway, connecting Angola, the Democratic Republic of the Congo and Zambia, has already been completed (United Nations, 2015a).

An essential underpinning to structural transformation is the mobilization of domestic resources for sustainable development, which has been stressed by the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and the 2030 Agenda for Sustainable Development (2030 Agenda) (both adopted in 2015). LDCs face a very considerable financing gap, due to a combination of low income levels, narrow tax bases, weak tax collection and management systems, and various forms of illicit financial flows (Bhattacharya and Akbar, 2014; Langford and Ohlenburg, 2015; UNCTAD, 2016a). This affects both economic performance and the attainment of social goals by limiting public sector investments and other government expenditures, notably on health and education. Tax reforms aimed at improving government revenues by simplifying and modernizing tax collection and expanding the tax base have been implemented by several LDCs in recent years, including Angola, Bangladesh, Burundi, Ethiopia, Guinea-Bissau, Liberia, Mauritania, Mali, Myanmar, Senegal and Uganda (IMF, 2011).

Many LDCs are compliant with, or candidates for, the Extractive Industries Transparency Initiative.

Several natural-resource-rich LDCs are acting to strengthen tax collection and management, as a means of redirecting resources towards fostering sustainable development. In this regard, transparency in public resource use can help to promote effective use of public revenues. A large number of LDCs have embraced the principles of the Extractive Industries Transparency Initiative (EITI), which promotes revenue transparency and accountability in extractive industries, and which is explicitly mentioned in the IPoA. Currently, 13 LDCs are EITI-compliant (Chad, the Democratic Republic of the Congo, Guinea, Liberia, Mauritania, Mozambique, Mali, the Niger, Sierra Leone, Timor-Leste, Togo, the United Republic of Tanzania and Zambia); 9 are candidates for EITI membership (Afghanistan, Burkina Faso, Ethiopia, Madagascar, Malawi, Myanmar, Sao Tome and Principe, Senegal and Solomon Islands); and 2 are suspended (the Central African Republic and Yemen). The fact that most of the current candidates have joined the list since 2013 is suggestive of increasing attention to the issue of transparency among LDCs. A positive example of management of resources rents is Timor-Leste, whose oil fund has been a successful example of directing resource rents to sustainable development, in contrast with the experiences of some other natural-resource-rich LDCs (Cornia and Scognamillo, 2016).

Most LDCs have made substantial advances in education in recent years.

Another key aspect of structural transformation is the development of human capital through education and training. As well as increasing labour productivity directly, this provides the human resource base needed for the development of more sophisticated production sectors and the development and adoption of better technologies. Most LDCs have made substantial advances in education in recent years, most notably at the primary level, although the Millennium Development Goal target of universal primary enrolment has not generally been achieved (UNCTAD, 2014). Several LDCs have introduced programmes designed to increase school attendance, including conditional cash or in-kind transfer programmes, such as the Education Sector Support Programme in

Cambodia and the Nationwide Female Stipend Programme in Bangladesh. Nepal has also enacted several cash transfer programmes in the areas of pensions, child grants and single women's allowances.

(c) Sectoral priorities

Some Asian LDCs have joined GVCs and stimulated linkages with their local economies.

Traditionally, development strategies have tended to focus on industrialization, and particularly the development of manufacturing production (UNCTAD, 2016b). In the current phase of globalization, this is often initiated by joining a global value chain (GVC). However, the developmental benefits of a country's insertion into GVCs depend on its nature, and are subject to important caveats (UNCTAD 2007, 2015b). Analysis of GVC participation in Asian LDCs indicates that the local private sectors in Bangladesh and Cambodia have been effective both in diversifying their production and in entering high-technology GVCs (DiCaprio and Suvannaphakdy, 2015). In Bangladesh, particularly, backward linkages from the garments sector have played an important role. In the Lao People's Democratic Republic, Myanmar and Nepal, however, it has been FDI rather than the domestic private sector that has taken the lead, giving rise to weaker incentives for the development of backward linkages.

In many LDCs growth has been led by construction and services rather than manufacturing.

Ethiopia has adopted an active industrial policy (UNCTAD, 2016b): the Growth and Transformation Plan (2010–2015) designated priority manufacturing industries, selected on the basis of resource availability, labour intensity, linkages to agriculture, export potential, and (relatively) low technological entry barriers. Priority sectors include garments and textiles, agro-processing, meat processing, leather and leather products, and construction. For each of these industries, supporting institutes were established to coordinate value chains and assist firms with technological upgrading. The Growth and Transformation Plan 2 (2015–2020) accords the highest priority to the leather products sector and the textile and garments sector. This active industrial policy has contributed to rapid growth in manufacturing value added and exports in recent years, though from a relatively low base, spurred in part by FDI inflows.

In many LDCs, growth has been led by construction and services rather than by manufacturing. In Rwanda, for example, the main drivers of growth have been tourism (supported by the establishment of the Rwanda Tourism University College in 2006) and ICT-related services. In Mali, growth has been led by telecommunications and transport activities, and to a lesser extent by trade and financial services. Senegal has experienced a relatively diversified growth path, services contributing more than one third of economic growth, compared with a quarter for industry. In the Lao People's Democratic Republic, construction and services have played a significant complementary role to natural resources (primarily water, minerals and forests).

Ethiopia has successfully combined agricultural diversification with increased food production.

As highlighted in UNCTAD (2015a), rural development, combining agricultural upgrading and parallel diversification into non-farm activities, plays a central role in structural transformation in LDCs. Key aspects of agricultural upgrading are increasing productivity in the sector and diversification, particularly towards higher-value crops. An important instrument for both is research and development, to develop and adapt inputs and production methods appropriate to local conditions, and to promote their uptake by producers. Research and development expenditures in agriculture have been increasing recently, in particular in Burundi, Madagascar, the Sudan, the United Republic of Tanzania and Uganda.

Ethiopia provides a good example of combining agricultural diversification and the development of high-value crops with increasing food production. Under its Agriculture Development-Led Industrialization Strategy, food production per capita increased by 70 per cent between 2001 and 2012 (Cornia

and Scognamillo, 2016), while cut flower exports increased from just 3 tons in 2003–2004 to more than 50,000 tons in 2011–2012, and export earnings from $0.32 million to about $200 million, creating employment both directly and indirectly through forward and backward linkages. While production was initiated by Ethiopian firms, foreign firms have increased their investment in the sector, accounting for 63 per cent of all firms operating in it in 2012, and have contributed significantly to technological development and marketing (UNECA, 2016).

Some LDCs have adopted a value chain approach to agricultural development.

Several LDCs have adopted a value chain approach to agricultural development. Burkina Faso's Agricultural Development Programme (2004–2015), for example, is aimed in part at "analysing and eliminating bottlenecks at every stage in the agricultural production chain", and the concept of value chains provides a policy framework for cereals, dairy products, ginger and coffee in Nepal. It also underpins the United Nations Development Assistance Framework for the Republic of Yemen 2012–2015 and Rwanda's Third Rural Sector Support Project. The African Cashew Initiative of the German Federal Ministry for Economic Cooperation and Development and the Bill and Melinda Gates Foundation, implemented in Benin, Burkina Faso and Mozambique (as well as in two non-LDCs, Côte d'Ivoire and Ghana) provides an interesting example of organizational assistance based on a sectoral supply chain.

(d) Reducing vulnerability: Peace, security and disaster preparedness

Conflict and insecurity tend to have a strong negative impact on trade, investment and development.

Though not included explicitly in the graduation criteria, peace and security are a critical foundation for development and progress towards graduation, given the often considerable negative effect of conflict and insecurity on trade, investment and development (Ikejiaku, 2009). Countries that experienced major violence between 1981 and 2005 had average poverty rates 21 percentage points higher than those that experienced no violence (World Bank, 2011). The negative externalities of conflicts also spill over to other countries; for example, 75 per cent of refugees are hosted by neighbouring countries. Moreover, while inter-State conflicts have declined, they have given way to new security risks, notably terrorism (Dahlman and Mealy, 2016). This highlights the importance of building State capacities to ensure peace and security, as well as to design and implement effective development policies.

Many LDCs are adopting a preventive approach to disaster preparedness.

However, several post-conflict States have been able to improve their security situations. Timor-Leste, for example, has emerged successfully from conflict, while the restoration of peace and security has contributed to rapid economic growth in Cambodia. In the Comoros, constitutional reforms adopted in 2009 transformed relations between the islands, significantly reducing tensions (World Bank, 2016).

Given the vulnerability of most LDCs to natural disasters, extreme weather events and climate change impacts, disaster preparedness is a critical issue for development. LDCs are increasingly adopting a preventive approach rather than relying on ex-post disaster response, and many have recently implemented institutional changes related to disaster reduction management. Eight LDCs (Burkina Faso, Ethiopia, the Lao People's Democratic Republic, Mauritania, Nepal, Solomon Islands, Vanuatu and Zambia) were among the 34 countries that reported integrating disaster risk reduction into their national development plans under the Hyogo Framework for Action 2005–2015: Building the Resilience of Nations and Communities to Disasters (United Nations, 2015a).

International support can play an important role in disaster preparedness in LDCs. In Eritrea, the Drought Resilience and Sustainable Livelihoods Programme 2015–2021, supported by the African Development Bank, provides

resources to mitigate the effects of recurrent droughts. In Kiribati, an LDC Fund project, Enhancing Food Security in the Context of Climate Change, is aimed at increasing resilience to climate change impacts through agricultural training, support to outer-island fisheries development initiatives, support for the establishment of community-based gardening and school gardening, and assistance with marketing of agricultural products.

E. The least developed countries group in 2025: Implications of the UNCTAD projections

The graduations projected by 2024 will have a disproportionate impact on the composition of the LDC group.

Overall, the UNCTAD projections reported in section B above imply a reduction in the total number of LDCs from 48 at the time of writing to 32 in 2025 (table 2.3).[11] Although this represents a reduction of only one third in the number of LDCs, it has the potential to alter the composition of the LDC group disproportionately, in terms of its geographical composition, structural characteristics, income level, poverty and social features. It will also affect the economics and geopolitics of the group, as well as its collective negotiating power in international forums, and has potentially important implications for the ISMs needed by LDCs from 2025 onwards. While the group is projected to shrink, its development challenges are expected to become greater, highlighting the need for increased support from the international community.

Of the 32 countries projected still to be LDCs in 2025, only two are outside Africa and only one is a small island economy.

This section seeks to provide an indication of some of the likely features of the LDC group in 2025, based on the results of these projections. In interpreting these results, the caveats regarding the projections themselves (as outlined in section B) should be borne in mind, particularly the potential effects of extraneous factors such as prolonged conflict. It should also be emphasized that the analysis is based on the current characteristics of each country rather than their projected characteristics in 2025, as it is not feasible within the scope of this exercise to project the socioeconomic characteristics of each LDC some 10 years into the future. The analysis also highlights differences between those LDCs expected to achieve graduation based on two criteria (including those that are progressing towards graduation with momentum) and those graduating via the income-only route.

1. Geographical features

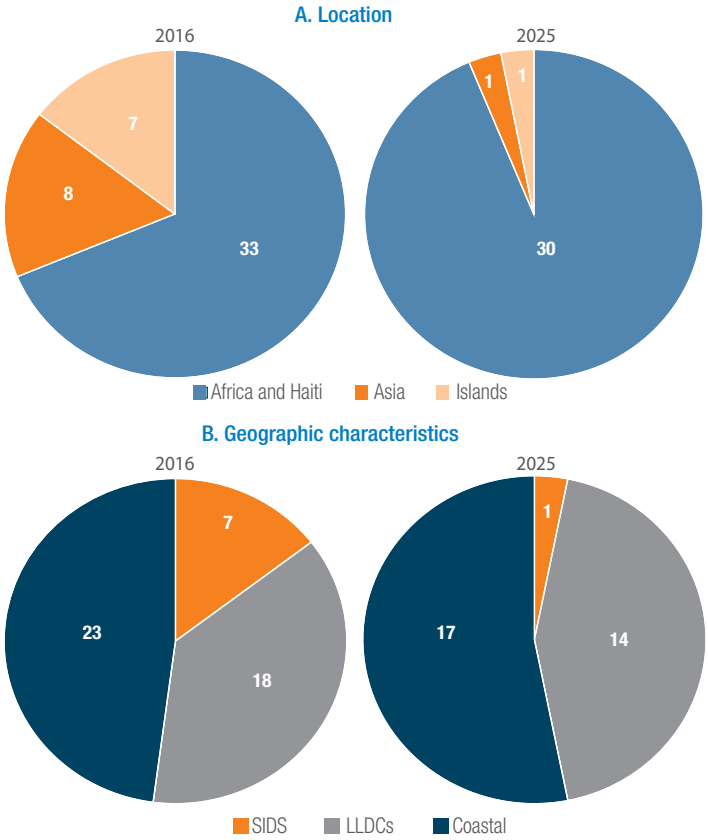
The GNI per capita of the countries projected to graduate by 2024 is almost double that of those projected to remain in the group in 2025.

If graduation were to take place as projected in table 2.2, by the mid-2020s 30 of the 32 LDCs would be in Africa, the sole exceptions being Cambodia and Haiti. Only one SIDS LDC would remain (the Comoros, which is also located in Africa). Since all but one of the current small island LDCs are expected to graduate by 2024, virtually all the remaining LDCs would be either LLDCs or coastal countries. Coastal countries would constitute the majority of the group, but the balance between coastal and landlocked countries would remain virtually unchanged (figure 2.5).

2. Output structure and income

As a result of the less advanced stage of structural transformation in the countries not expected to have graduated by 2024, the LDC group is projected to be more rural and agriculturally based than at present. In the 32 countries projected to be LDCs in 2025, the sector generates 29.5 per cent of GDP, double the proportion in the 16 countries projected to graduate in 2017–2024. Even in the latter group, however, this figure is much higher than in ODCs (table 2.3). These different levels of structural transformation are reflected in the income

Figure 2.5. Geographical features of the present and projected group of LDCs



Source: UNCTAD secretariat elaboration.
Note: Figures indicate the number of countries.

Table 2.3. Structural indicators of LDCs and ODCs, 2010–2015

	Output structure (Share of gross value added, per cent)[a]				Population (Per cent)[b]		Productivity and poverty		Financing for development (Per cent of GDP)	
	Agri-culture	Mining and utilities	Manu-factures	Services	Share of rural population	Agricultural share of employment[c]	Labour productivity (2005 $/ worker)[a]	Population below $1.25 a day (Per cent)[d]	ODA inflows[a]	Remit-tances[a,e]
Present group of LDCs (48 countries)	21.8	16.1	10.1	44.7	69.4	59.7	3 015	45.7	5.1	4.4
Expected to graduate in 2017–2024 (16)	15.1	22.2	11.0	44.3	67.9	46.6	4 351	35.5	3.0	5.8
Expected to graduate based on two criteria[f]	21.1	7.0	15.3	50.2	68.5	46.7	1 903	34.8	4.2	8.2
Expected to graduate based on income only[g]	4.7	48.9	3.4	33.8	60.9	45.4	10 066	42.4	0.4	0.1
Projected group of LDCs by 2025[h] (32)	29.5	9.1	9.1	45.2	70.4	68.1	1 606	50.3	7.8	2.8
Other developing countries	8.6	11.5	20.7	52.6	48.6	30.3	17 445	12.7	0.2	1.4

Sources: UNCTAD secretariat calculations, based on data from UNCTAD, UNCTADstat database (accessed August 2016); International Labour Organization, World Employment and Social Outlook, Trends 2016 database (accessed August 2016); and World Bank, World Development Indicators database (accessed August 2016).

Notes:

a 2012–2014.
b 2013–2015.
c Data on employment are missing for the following countries: Djibouti, Kiribati, Sao Tome and Principe, Tuvalu and Vanuatu.
d 2010–2011. The $1.25/day poverty line is used because at the time of writing poverty data based on the revised $1.9/day poverty line were not available for several LDCs.
e Data on remittances are missing for the following countries: the Central African Republic, Chad, Equatorial Guinea, Eritrea, Mauritania, Somalia and South Sudan.
f Countries expected to graduate based on two criteria: Afghanistan, Bangladesh, Bhutan, Djibouti, Kiribati, the Lao People's Democratic Republic, Myanmar, Nepal, Sao Tome and Principe, Solomon Islands, Tuvalu, Vanuatu and Yemen.
g Countries expected to graduate based on income only: Angola, Equatorial Guinea and Timor-Leste.
h Projected group of LDCs by 2025: Benin, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, the Niger, Rwanda, Senegal, Sierra Leone, Somalia, South Sudan, the Sudan, Togo, Uganda, the United Republic of Tanzania and Zambia.

levels of the two subgroups of LDCs. In 2014, the average GNI per capita of the projected graduates of 2017–2024 was $1,377, nearly double that of the LDCs projected to graduate later ($731). Thus the LDC group in 2025 will be much poorer than the current group.

Income-only graduates have a much weaker manufacturing base than those graduating based on two criteria.

Among the countries projected to graduate in 2017–2024, there is a sharp contrast between those projected to graduate based on two criteria and the three income-only graduates. Since the latter rely heavily on extractive industries, the mining sector contributes almost half of their output, compared with just 7 per cent in the former group.[12] Conversely, manufacturing contributes 15.3 per cent of total output in the countries graduating on the basis of two criteria compared with only 3.4 per cent in the income-only countries, reflecting the much greater degree of structural transformation in the former group. The contribution of services to total economic activity in the 2017–2024 graduates is approximately half, similar to ODCs (table 2.3).

3. Urbanization and the rural economy

Agriculture accounts for 46.6 per cent of employment in the LDCs projected to graduate by 2024, but 68.1 per cent in other LDCs.

Differences in the extent of structural transformation are also reflected to some extent in relative levels of urbanization. In the countries projected to graduate in 2017–2024, 67.9 per cent of the population lives in rural areas, slightly below the current LDC average of 69.4 per cent. Hence, their graduation is projected to increase the rural population of the group to 70.4 per cent in 2025. The contrast is much sharper in the case of agricultural employment, which accounts for 46.6 per cent of total employment in the next wave of graduates, but 68.1 per cent in the post-2025 group. The projected graduations will thus increase the agricultural share of employment substantially, from 59.7 per cent in the current LDC group to 68.1 per cent in 2025. In all cases, the contribution of agriculture to employment is still much higher than in ODCs (30.3 per cent) (table 2.3).

The projected graduations further increase the importance of rural economic transformation after 2025.

Thus, the graduations from the group projected up to 2025 will increase the critical importance of rural development still further. The much greater differences observed between pre- and post-2025 graduates in agricultural employment than in rural population underlines the key role of rural economic diversification and the development of non-farm rural activities in structural transformation (UNCTAD, 2015a).

4. Productivity and poverty

Differences in the sectoral composition of employment and output have major implications for the level of labour productivity, which is almost three times as high in the countries projected to graduate in 2017–2024 as in the post-2025 LDC group. However, even in the former group, labour productivity is only a quarter of that in ODCs (table 2.3).[13]

Poverty is significantly lower in LDCs projected to graduate on the basis of two criteria than in income-only graduates.

Poverty is significantly less prevalent in the LDCs projected to graduate in 2017–2024 than in the post-2015 graduates, with a headcount ratio of 35.5 per cent as compared with 50.3 per cent (table 2.3). The former group have also achieved greater progress in poverty reduction than the latter. Among the 2017–2024 graduates, poverty is significantly lower in those expected to graduate based on two criteria (34.8 per cent) than in the income-only graduates (42.4 per cent), reflecting the limited potential of extractive industries to generate inclusive economic growth. Poverty rates are much higher in all the country groups identified in table 2.3 than in ODCs, demonstrating the very considerable further improvement required to eradicate extreme poverty (Sustainable Development Goal 1).

5. Financing for development

Patterns of external financing are also significantly different between the two subgroups of LDCs. In the countries projected to graduate in 2017–2024, ODA is equivalent to 3 per cent of GDP (compared with 0.2 per cent for ODCs) (table 2.3). For the post-2025 graduates, aid dependence is much greater, with ODA equivalent to 7.8 per cent of GDP, leaving these countries particularly prone to the negative aspects of aid dependency (as discussed in chapter 3 of this Report).

The LDC group in 2025 will be more aid dependent, and receive much more limited remittances.

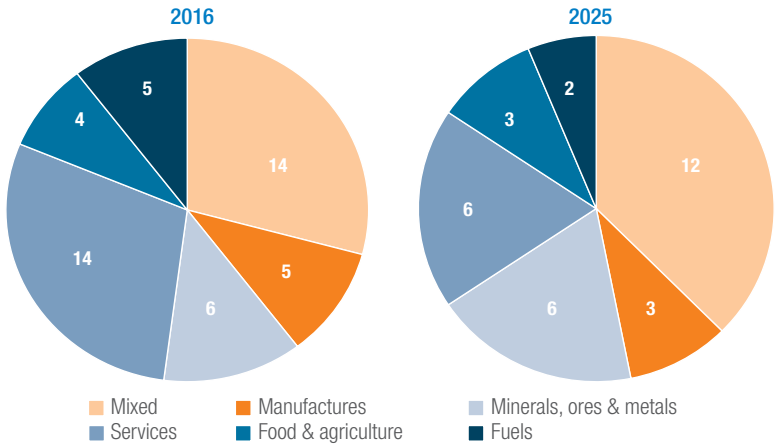
Remittances have become an increasingly important financial inflow for many LDCs since the 1990s, and are of particular significance in the LDCs projected to graduate in 2017–2024, where they are equivalent to 5.8 per cent of GDP. They are especially important to Bangladesh, Kiribati, Nepal, Tuvalu and Yemen, helping to lower poverty and, in some cases, to finance productive investment (UNCTAD, 2012). Remittances to the projected group of LDCs in 2025 are much more limited, equivalent to just 2.8 per cent of GDP. They are nonetheless important to some of the countries that are making faster progress towards graduation in this group, such as Lesotho and Senegal. This confirms the potential role of remittances, with appropriate policies, not only in boosting household incomes, but also in supporting productive investment and structural transformation.

6. Major exports

Extractive industries will remain a major source of foreign exchange earnings for the LDC group in 2025, as well as a major driver of the domestic economic change. None of the current exporters of minerals, ores and metals is projected to graduate by 2024; and two of the five current fuel exporters are also projected to be unable to graduate in this period (Chad and South Sudan).[14] The largest group of exporters in the 2025 LDC Group is mixed exporters, representing 12 of the remaining 32 LDCs (figure 2.6). However, this would be a very heterogeneous group, ranging from countries still relying on extractive industries for the bulk of foreign exchange earnings, but without either fuels or minerals predominating (Burkina Faso, Mozambique, the Niger and the Sudan), to countries that have diversified their productive structures substantially (for example, Ethiopia and Senegal). The relatively weak graduation prospects of the former group, in particular, reflects the difficulties encountered by most LDCs in

None of the mineral exporting LDCs and only three of the five fuel exporters are projected to graduate by 2024.

Figure 2.6. Export specialization of the present and projected group of LDCs



Source: UNCTAD secretariat elaboration.
Note: Figures indicate the number of countries.

transforming their extractive industries into growth poles that generate spillovers of income, employment, productivity and technology to other economic sectors.

Only two manufactures exporters are projected to graduate by 2024, but two others are projected to be close to graduation.

The group of LDC services exporters in 2025 would also be quite heterogeneous, encompassing both countries with limited productive capacities (for example, the Central African Republic, the Comoros and Eritrea) and others that have been more successful in diversifying their economies and developing their productive capacities (for example, Rwanda and Uganda).

At first sight, it might seem surprising that not all manufactures exporters are expected to have graduated by 2025. In principle, diversification towards manufactures is a major sign of structural transformation, as it provides a means of increasing overall labour productivity and diffusing technological innovation into the wider economy. However, even among manufactures exporters, the extent to which these processes occur varies considerably. Nonetheless, while only two manufactures exporters (Bangladesh and Bhutan) are projected to graduate by 2025, two others are expected to be close to graduation: Cambodia is projected to satisfy all three graduation criteria by 2021, and Lesotho to be close to all three graduation thresholds. The one exception to this favourable performance is Haiti, which is projected to remain some way from graduation thresholds, particularly for income per capita and the HAI.

Income-only graduates have much less diversified exports than other projected graduates.

Among the exporters of food and agricultural goods, the only SIDS in the group (Solomon Islands) is projected to graduate by 2024, while the other three countries (Guinea-Bissau, Malawi and Somalia) remain in the initial stages of structural transformation and will therefore require more time to develop their productive capacities and reach graduation thresholds.

7. Export concentration

Some of the 2025 LDC group have already diversified their exports substantially.

There is a very marked differentiation between the LDC subgroups based on graduation status in terms of export concentration. The countries projected to graduate on the basis of two criteria before 2024 have achieved significant export diversification since the mid-1990s, reducing their export concentration from 0.46 in 1995 (where 1 represents absolute concentration) to 0.38 in 2014, significantly below the figure for the post-2025 graduates (0.42). By contrast, those projected to graduate via the income-only route have maintained an extremely concentrated export structure, reflecting their heavy dependence on energy exports: their average export concentration was 0.91 in 2014, having increased from an already high level of 0.88 in the mid-1990s, particularly during the so-called commodity super-cycle of 2003–2011 (table 2.4). This further underlines the potential for LDCs to graduate without having undergone significant structural transformation of their economy, particularly (though not exclusively) in the case of those graduating on the basis of the income-only criterion.

Table 2.4. Export concentration index of LDCs and ODCs, 1995–2014, selected years

	1995	2002	2011	2014
Present group of LDCs (48 countries)	0.55	0.57	0.65	0.58
Expected to graduate in 2017–2024	0.60	0.65	0.74	0.68
Expected to graduate based on two criteria	0.46	0.46	0.43	0.38
Expected to graduate based on income only	0.88	0.90	0.92	0.91
Projected group of LDCs by 2025	0.51	0.44	0.51	0.42
Other developing countries	0.21	0.22	0.26	0.24

Source: UNCTAD secretariat calculations, based on data from UNCTAD, UNCTADstat database (accessed June 2016).
Note: For the compostion of groups, see notes to table 2.2.

Just as there is differentiation among the pre-2025 graduates, so there are significant differences among the countries projected to remain in the group in 2025 in terms of export concentration. Benin, Ethiopia, the Gambia, Liberia, Rwanda and Uganda, in particular, have all made considerable progress in export diversification, reducing their concentration indices by at least 0.2 between 1995–1996 and 2013–2014. This is indicative of the different rates of progress towards diversification and structural transformation among this group.

The projected graduations will widen the gap between the remaining LDCs and ODCs still further.

8. Conclusions

Three key points emerge from the above analysis. First, the graduation projections imply significant changes in the nature of the LDC group by 2025. In particular, it will be poorer and exhibit more features associated with earlier stages of development (for example, larger shares of agriculture in output and employment, more limited urbanization, higher export concentration, greater aid dependency and lower access to social services) than in 2016. Without decisive and efficient measures, nationally and internationally, to promote accelerated development in the 32 countries projected to remain in the group, the projected graduations would thus widen the gap between the LDC group and the ODCs still further.[15] As discussed in chapter 5, averting this outcome would require heightened attention from both national authorities and the international community.

Countries projected to graduate on the basis of two criteria are closer to the "graduation with momentum" model than income-only graduates.

Second, there are substantial differences among the countries on the economic trajectory leading to graduation; and the different paths, patterns and motors of the graduation process have crucial implications for the development process in the post-graduation phase. There is a particular distinction between those countries graduating via the income-only route, which tend to achieve limited structural transformation, and those that graduate on the basis of two criteria, many of which experience a more broadly based process of economic and social development, including some degree of structural transformation and economic diversification. The latter course corresponds more closely with the concept of “graduation with momentum”, providing a more solid foundation for development in the post-graduation phase. By contrast, while more narrowly based economic growth (for example, associated with enclave sectors) may well increase income per capita, it is unlikely to lead to social and economic inclusion or to provide a basis for sustainable development progress, unless effective policies and strategies are put in place to reinvest resource rents in productive capacity development in other sectors.

Third, while the LDC group in 2025 is expected to be more homogeneous geographically – with only two countries outside Africa, and only one SIDS – it will in other respects be quite differentiated. Some of the countries projected to remain in the group are achieving visible progress in the development of productive capacities, economic diversification and the development of higher-value-added sectors and products; but others remain in the initial stages of these processes.

While the 2025 LDC group will be more homogeneous geographically, there will be marked differences in productive capacities.

F. Summary

- Only 16 countries are projected to achieve graduation by 2024, well short of the graduation target established by the IPoA.
- While some of these countries are expected to graduate through a broadly based process of development, this is by no means always the case, particularly among countries graduating via the income-only route.

- While LLDCs have experienced some difficulty in attaining graduation, SIDS perform very well, as the design of the graduation criteria means that their relatively high incomes and human development offset their particularly acute vulnerability.
- None of the four countries that have graduated to date pursued policies explicitly aimed at graduation; but most of those now close to graduation have adopted graduation as a specific goal.
- The four countries that have graduated to date have done so in part by virtue of quality of governance, peace and social stability, economic and social planning, good infrastructure, emphasis on education, and prudential and forward-looking macroeconomic management.
- In the current LDCs, national strategies and domestic policies that could contribute to graduation include those aimed at laying the foundations of structural transformation through infrastructure investment, domestic resource mobilization, economic diversification and education.
- Almost all of the Asian and island LDCs are projected to graduate by 2024, implying that the 32 countries comprising the LDC group in 2025 would include only one SIDS, and only two countries outside Africa.
- By 2025, the LDC group is also projected to exhibit more features associated with earlier stages of development: lower income, higher poverty, larger shares of agriculture in output and employment, more limited urbanization, higher export concentration and greater aid dependency.
- This implies a wider development gap between the remaining LDCs and ODCs than at present, unless effective national and international action is taken to address their needs.

Notes

1 Timor-Leste is classified in this Report as a services exporter because a large part of its fuel exports are accounted as service exports. Therefore, the basis of the country's services exports is fuel extraction.

2 See notes to table 2.2 for caveats on the graduation prospects of this country.

3 This does not include the three countries that at the time of writing of that document had already been scheduled to graduate or found eligible for graduation (Equatorial Guinea, Tuvalu and Vanuatu).

4 Available at https://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx (accessed 28 October 2016).

5 The UNCTAD list of SIDS is based on the following three criteria: (a) islandness: only "genuine" islands are considered; (b) Stateness: only self-governing island States are taken into account; (c) smallness: a population not exceeding 5 million (except for Papua New Guinea, whose population was within the bounds when the list was established). Only island States with a clear developing status, in terms of socioeconomic characteristics (national income and/or income distribution) are considered (UNCTAD, 2004). The list is composed of 29 countries, as shown in figure 2.1.

6 The SAMOA Pathway (United Nations, 2014b) was adopted by the Third International Conference on Small Island Developing States, held on 1–4 September 2014 in Apia.

7 As mentioned previously in this chapter, the basis for the graduation of Timor-Leste is fuel extraction.

8 Somoa, Ministry of Finance (2002, 2005, 2008).

9 For the structure and composition of the EVI, see box figure 1.1 in chapter 1.

10 In development policy discourse a shortcut is often taken, which states that upon graduation countries stop being LDCs and become middle-income countries. This is not precise. Upon graduation, countries stop being LDCs and become non-LDC developing countries (which this Report series calls "other developing countries"). Typically, they have already become middle-income countries prior to graduation and in exceptional cases have even reached the group of high-income countries.

11 According to the projections, in 2025 the following countries would be LDCs: Benin, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, the Niger, Rwanda, Senegal, Sierra Leone, Somalia, South Sudan, the Sudan, Togo, Uganda, the United Republic of Tanzania and Zambia.

12 These figures refer to the share of mining and utilities (such as water and electricity services).

13 The very high labour productivity achieved by the countries bound to graduate based on income-only (table 2.2) is the result of the combination of very high capital intensity of the extractive industries on which their economies are based with relatively small populations.

14 South Sudan has not been formally classified according to export specialization for this Report due to the absence of reliable trade figures, and hence it is excluded from the statistical aggregates built according to this criterion presented elsewhere. However, for the projections of the expected features of the LDC group by 2025, we have supposed that the country is and will remain mainly a fuel exporter.

15 The economic and social gap between the present group of LDCs and ODCs is analysed in chapter 1.

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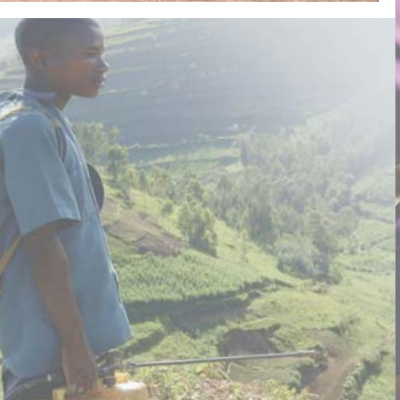
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CHAPTER 3

The Contribution of International Support Measures to Graduation











A. Introduction

Over the years, the growing recognition by the international community of least developed countries' (LDCs) special needs has led to the establishment of a number of international support measures (ISMs) in their favour, beyond those available to other developing countries (ODCs). The continued relevance of the LDC category and of related ISMs has been reaffirmed repeatedly in the key international agreements of 2015, including the 2030 Agenda for Sustainable Development (2030 Agenda), the Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda), the Sendai Framework for Disaster Risk Reduction and the Paris Agreement of the twenty-first session of the Conference of the Parties (COP21) to the United Nations Framework Convention on Climate Change (UNFCCC).

The relevance of LDC-specific ISMs has been reaffirmed in several recent international agreements…

The effectiveness of such ISMs is gradually coming under closer scrutiny, reflecting a growing emphasis on the monitoring and evaluation of international support, notably in the context of the Midterm Review of the Implementation of the Programme of Action for the Least Developed Countries for the Decade 2011–2020 (Istanbul Programme of Action (IPoA))[1] and the biennial Global Reviews of Aid for Trade. The effectiveness of the ISMs should be assessed not only in terms of their direct outputs, but also, more fundamentally, against the rationale for the establishment of the LDC category. As noted in chapter 1, the ultimate purpose of LDC-specific ISMs is to enable LDCs to overcome the constraints and vicious circles that undermine their ability to benefit fully from participation in international markets.

…but their effectiveness is coming under closer scrutiny.

In principle, graduation reflects the achievement of greater resilience and/or reduced exposure to the structural challenges that are the raison d'être of the LDC category.[2] This is the key to narrowing the gap between LDCs and ODCs. As argued in earlier chapters, addressing these handicaps to achieve "graduation with momentum" requires structural transformation. Thus the effectiveness of ISMs may be assessed in part on the basis of their contribution to the structural transformation, upgrading of production and export diversification that form the basis for graduation with momentum.

Three caveats should be highlighted at the outset. First, the multiplicity of ISMs — spanning areas as diverse as finance, trade, technology, climate change and technical assistance — makes analysis particularly complex and challenging, especially given the wide differences in the initial conditions of LDCs. Second, as noted in chapter 2, there are various possible paths towards graduation. Hence, even if an ISM has proved decisive in one case, this does not necessarily mean that it will play an important role elsewhere. Third, even using sophisticated econometric techniques, the attribution of an LDC's progress to one or more ISMs is unlikely to be definitive and is necessarily subject to qualifications.

ISMs should be assessed in part on the basis of their contribution to structural transformation.

Subject to these caveats, the present chapter seeks to shed some light on the effectiveness of LDC-specific ISMs in the context of graduation. It examines the extent to which ISMs contribute to transformative change in the LDCs and thus enhance their prospects for graduation, in line with the IPoA objectives. It begins with an overview of the key ISMs available to the LDCs (section B) before moving on to a brief assessment of their overall effectiveness in each of the main areas of finance, trade and technology (sections C–E). Section F discusses the contribution of ISMs to past graduation cases, and section G presents the findings of a survey of the views of LDCs on the developmental impact of ISMs, conducted for this Report. Finally, section H provides some conclusions from the foregoing discussion.

B. International support measures - An overview

Over the years, the increasing recognition of LDC development needs has been mirrored in the establishment of a growing number of dedicated ISMs intended to support their development, beyond those available to developing countries generally. The Support Measures Portal for Least Developed Countries — established and maintained by the Committee for Development Policy (CDP) Secretariat[3] — lists 136 such measures across the fields of development finance, trade, technology and technical assistance. Table 3.1 provides a schematic overview of the major ISMs in each of these four areas, which are discussed in greater detail in the following sections of the chapter.[4]

There are 136 LDC-specific ISMs, which vary widely in nature, focus and content.

As table 3.1 demonstrates, despite their common objective, existing ISMs encompass widely different instruments in terms of their nature, focus and content. While some are clearly defined and directly implementable by the international community (for example, preferential market access and LDC-specific facilities such as the LDC Fund and the Enhanced Integrated Framework (EIF)), others require action by LDCs themselves, including many special and differential treatment (SDT) provisions. These ISMs thus depend on LDCs' institutional capacities, including legal and technical skills and/or effective interministerial coordination. Other ISMs are essentially indicative in nature, with no concrete mechanisms for mutual accountability or enforcement, resulting in limited implementation. This last case is epitomized by the commitment by donor countries, dating back to 1990 but still unfulfilled, to provide official development assistance (ODA) to LDCs equivalent to 0.15–0.20 per cent of their gross national income (GNI).

Given this heterogeneity, and the very different circumstances of LDCs themselves, the relative importance of different ISMs in fostering progress towards graduation varies across LDCs, according to each country's structural characteristics and ability to leverage support in different areas. In general, however, access to development finance and trade preferences are regarded as the most significant and readily accessed ISMs.

Development finance and trade preferences are regarded as the most readily accessed ISMs.

While ISMs are undoubtedly helpful, especially in these two areas, their long-term development impact is typically circumscribed and their adequacy relative to LDCs' needs for productive-capacity development is at best questionable (UNCTAD, 2010). Moreover, as the following assessment highlights, the limitations and shortcomings of existing ISMs have been compounded by the ambitious targets agreed upon by the international community in the context of the IPoA and the 2030 Agenda.

C. Finance-related international support measures

There are a limited number of financial ISMs for LDCs.

Financial support and aid flows have historically received considerable emphasis in the policy discourse around LDCs (and developing countries more generally), particularly in the context of the global partnership for development. This partly reflects the fact that ODA remains the largest source of external finance for LDCs as a whole and a key source of public revenues, although its importance in both respects varies widely between individual countries.[5] However, the high visibility of the issue and the major financial and development role of ODA contrasts markedly with the limited number of financial ISMs for

Table 3.1. Main international support measures in favour of LDCs

	International support measure	Observations	Legal sources
Finance	ODA target 0.15-0.20 per cent of donor countries GNI	Some targeted budget/funds available by some multilateral organizations (UNDP, UNICEF, WFP, GEF-LDCF, UNCDF, etc.)	Paris Programme of Action for the LDCs (1990)
	Aid modalities: untied aid	The DAC recommendation explicitly aims at (i) untying ODA to the LDCs to the greatest extent possible; (ii) promoting and ensuring adequate ODA flows; and (iii) achieving balanced efforts among DAC members in untying aid	Recommendation of DAC High Level Meeting (2001)
	Aid modalities: grant element	The recommendation stipulates that the average grant element of all committments should be a minimum of 90% for all LDCs (on a given year) or at least 86% to each LDC (over 3 years)	Recommendation on terms and conditions of aid (1978)
	LDC Fund	Established by the United Nations Framework Convention on Climate Change (UNFCCC) to assist LDCs to carry out the preparation and implementation of national adaptation programmes of action	
	Cap to contributions to United Nations regular budget and peacekeeping operations	LDC contributions to the regular budget of the United Nations are capped at 0.01 per cent of the total United Nations budget (in 2015 six LDCs benefitted from the cap, namely Angola, Bangladesh, Equatorial Guinea, Myanmar, the Sudan and Yemen)	
	General support measures	LDC officials receive travel support to attend meetings of the General Assembly and other UN-related meetings and conventions	
Trade	LDC accession to WTO	Guidelines aim at streamlining and facilitating LDCs' accession to the WTO, keeping in mind that WTO members should exercise restraint in seeking concessions from acceding LDCs.	Decision of the Sub-committee on LDCs of the WTO WT/COMTD/LDC/21 (2012), WT/L/508
	Preferential market access	Preferential schemes are typically unilateral and non-reciprocal (as exceptions to the MFN principle), and provide variable extents of preference margins. Some but not necessarily all of them are LDC-specific; for instance, most GSP schemes encompass some LDC-specific sub-schemes.	GATT enabling clause (1979), General Council Decision WT/L/304 (1999) and WT/L/759 (2009), Hong Kong ministerial declaration WT/MIN(05)/DEC (2005). In addition, unilateral decisions by preference-granting countries
	Preferential rules of origin for LDCs	Best endeavour calling for more flexible rules of origin applied to LDC-originating exports; implementation requires LDCs to negotiate with trading partners	Annex F of the Hong Kong Ministerial Declaration WT/MIN(05)/DEC (2005); Ministerial Decisions WT/MIN(13)/42, WT/L/917 (2013) and WT/MIN(15)/47 — WT/L/917 (2015)
	SDT in GATS	Special priority is given to LDCs with a view to increase their participation to services trade (art. IV.3), including through special treatment (art. XIX.3) and cooperation on telecommunications provision (annex on Telecommunications)	General Agreement on Trade in Services (1995)
	Services waiver	Waiver from MFN treatment (under GATS) for LDC services and service providers. Operationalization is still on-going, and full implementation requires LDCs to negotiate with trading partners	WTO Ministerial Declarations WT/L/847 (2011), WT/L/982 (2015)
	SDT in Trade Facilitation Agreement*	LDCs are granted more flexible terms for the categorization of various measures and their implementation. Other developing countries are also granted SDT, though on less flexible terms	Part II of the Trade Facilitation Agreement WT/MIN(13)/36, WT/L/911 (2013)
	Agreement on Agriculture	Under article 15.2, LDCs are not required to commit to reduce tariffs or subsidies. Under article 16, besides, developed countries shall take action according to the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries; and the Committee on Agriculture shall monitor, as appropriate	Agreement on Agriculture (1994) Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries (1994)
	Agreement on Trade-Related Investment Measures (TRIMs)	Under art. 5.2 and 5.3 LDCs are granted a 7-year transitional period (potentially renewable) to eliminate investment measures inconsistent with the provisions of the TRIMS Agreement. So far only Uganda notified TRIMs to the WTO	Agreement on Trade-Related Investment Measures (1994) Annex F of the Hong Kong Ministerial Declaration WT/MIN(05)/DEC (2005).
	Subsidies and countervailing measures	Under art. 27.2 and Annex VII, LDCs are exempted from the prohibition of subsidies contingent upon export performance	Agreement on Subsidies and Countervailing Measures (1994)
	Dispute settlement	Under art. 24 WTO members should exercise due restraint in raising matters involving LDCs (to date no LDC participation as defendant), and LDCs could request good offices of Director General in settling a dispute	Rules and Procedures Governing the Settlement of Disputes - annex 2 of the WTO Agreement (1994)

Table 3.1 (contd.)

	International support measure	Observations	Legal sources
Technical assistance	Enhanced Integrated Framework (EIF)	The EIF is a multi-donor programme which supports LDCs to increase their participation in the international trade, focusing on: (i) mainstreaming trade into national development strategies; (ii) coordinating the delivery of trade-related technical assistance; and (iii) building trade capacities. Set up in 1997, it was subsequently reviewed in 2005, and its mandate has been extended until 2022	
Technology	TRIPS implementation: extension of the transition period	Transition period for LDCs (under article 66.1) extended until July 2021	Decision of the Council for TRIPS of the WTO IP/C/64 (2013)
	TRIPS agreement in relation to pharmaceutical products: extension of the transition period, and waiver from obligations under art. 70.8 and 70.9	Transition period further extended until January 2033; waiver for obligations under art. 70.8 and 70.9 extended to the same date	WTO General Council Decision WT/l/971 and Decision of the Council for TRIPS IP/C/73 (2015)
	TRIPS obligations on technology transfer	Under article 66.2, developed country members shall provide incentives to enterprises and institutions to promote and encourage technology transfer to LDCs	Agreement on Trade-Related Aspects of Intellectual Property Rights (1994)
	Technology Bank	The Istanbul Programme of Action calls for the establishment of a Technology Bank and Science, Technology and Information supporting mechanism dedicated to LDCs. The Governing Council of the new institution met for the first time in July 2016, and full operationalization is stated to be undertaken	Istanbul Programme of Action (2011)

Source: UNCTAD secretariat compilation, based on CDP (2010), UN (2011), and WTO (2016).
Notes: Most of the measures mentioned in the table are LDC-specific. However, some of them are also available to some ODCs.
EIF: Enhanced Integrated Framework, GATS: General Agreement on Trade in Services, GATT: General Agreement on Tariffs and Trade, GEF-LDCF: Global Environment Facility - LDC Fund, GSP: Generalized System of Preferences, MFN: Most-favoured nation, SDT: (special and differential treatment, TRIMs: Agreement on Trade-Related Investment Measures, TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights, UNCDF: United Nations Capital Development Fund, UNDP: United Nations Development Programme, UNFCCC: United Nations Framework Convention on Climate Change, WFP: World Food Programme.
* The Trade Facilitation Agreement had not yet entered into force at the time of writing this Report.

LDCs. As well as the widely cited target for ODA to LDCs as a proportion of donors' GNI, these include commitments to untie aid to LDCs and to ensure a minimum average grant element, as well as access to LDC-specific financial windows, notably in the context of climate finance.

Aid-related issues have been addressed in several previous editions of *The Least Developed Countries Report* (UNCTAD, 2006, 2009, 2010, 2014a). These reports have consistently emphasized the importance to LDCs' sustainable development of adequate ODA to support the expansion of productive capacities, and the role of ODA as a complement to LDCs' domestic resource mobilization, which plays a key role in limiting aid dependency. They have also highlighted several key issues in the traditional aid architecture:

Past LDC Reports *have emphasized the importance of adequate ODA to support the expansion of productive capacities,*

- The inadequacy of ODA flows relative to LDCs' needs, notably in terms of infrastructural and technological gaps, and shortfalls from the long-standing international targets enshrined in Millennium Development Goal 8 and reaffirmed in Sustainable Development Goal 17;
- The tendency of the sectoral allocation of ODA to privilege social sectors at the expense of the productive sectors and social overhead capital (the systems and services on which production in all sectors depends);
- The need to leverage development cooperation more effectively for the consolidation of LDCs' domestic resource mobilization (notably by supporting tax revenue collection and management systems);
- The limited alignment of ODA with recipient countries' own development strategies, undermining their ownership of the development agenda;

- Uneven progress on the aid effectiveness agenda, and the consequent persistence of unpredictability, proliferation of aid channels, fragmentation and lack of harmonization of administrative requirements, all of which unnecessarily overstretch the institutional capacities of recipient countries;
- The importance of building on synergies and complementarities between development cooperation with traditional donors and with Southern development partners, taking account of their different priorities and operational approaches.

The significance and effectiveness of LDC-specific financial ISMs is debatable.

Many of these concerns are reflected to varying degrees in the IPoA (notably paras. 113–116). While these sections of the IPoA refer to aid from a more general perspective, based on the ample (and often controversial) literature on its developmental impact, they provide a useful starting point for an assessment of the contribution of financial ISMs to graduation with momentum.

Notwithstanding the critical role ODA has traditionally played in most LDCs, the significance and effectiveness of LDC-specific financial ISMs is debatable, not least because of the lack of mutual accountability in their delivery. While LDC graduates have benefited from substantial financial support from international donors and development partners, it is open to question to what extent this has been driven by their LDC status and access to financial ISMs rather than by geopolitical considerations. Moreover, while past LDC graduates have been able to harness aid resources for productive-capacity development, this may not be the case for all current LDCs, especially those in conflict or post-conflict situations or with weak institutional frameworks.

The target of 0.15-0.20 per cent of donor GNP for ODA to LDCs was set in 1981…

1. Volume of official development assistance

The Report of the Secretary-General of the United Nations Conference on the Least Developed Countries to the first such conference in 1981 (United Nations, 1983a) called for the establishment of a specific target for ODA to LDCs of 0.15 per cent of donors' gross national product (GNP) by the first half of the 1980s, rising to 0.20 per cent during the second half of that decade. This proposal was reflected in the Substantial New Programme of Action for the LDCs adopted at the same conference, and reiterated in various forms in subsequent Programmes of Action for the LDCs (United Nations, 1983b). Accordingly, in 2011 the IPoA stated that (United Nations, 2011: para. 116.2):

...but there is little evidence that LDC status affects aid allocations.

(a) Donor countries will implement the following actions … as soon as possible:

(i) Donor countries providing more than 0.20 per cent of their GNP as ODA to least developed countries: continue to do so and maximize their efforts to further increase ODA to least developed countries;

(ii) Other donor countries which have met the 0.15 per cent target: undertake to reach 0.20 per cent expeditiously;

(iii) All other donor countries which have committed themselves to the 0.15 per cent target: reaffirm their commitment and undertake either to achieve the target by 2015 or to make their best efforts to accelerate their endeavours to reach the target;

(iv) During the period of the Programme of Action, the other donor countries: exercise individual best efforts to increase ODA to least developed countries with the effect that collectively their assistance to least developed countries will significantly increase;

While this quantitative target was intended to provide LDCs with some degree of priority in terms of ODA allocation, there is little evidence suggesting that LDC status in fact plays a significant role in this respect. Only a few bilateral donors have established LDC-specific programmes; and, while multilateral institutions

have some financing windows earmarked for LDCs, these do not play a major role in terms of overall disbursements.

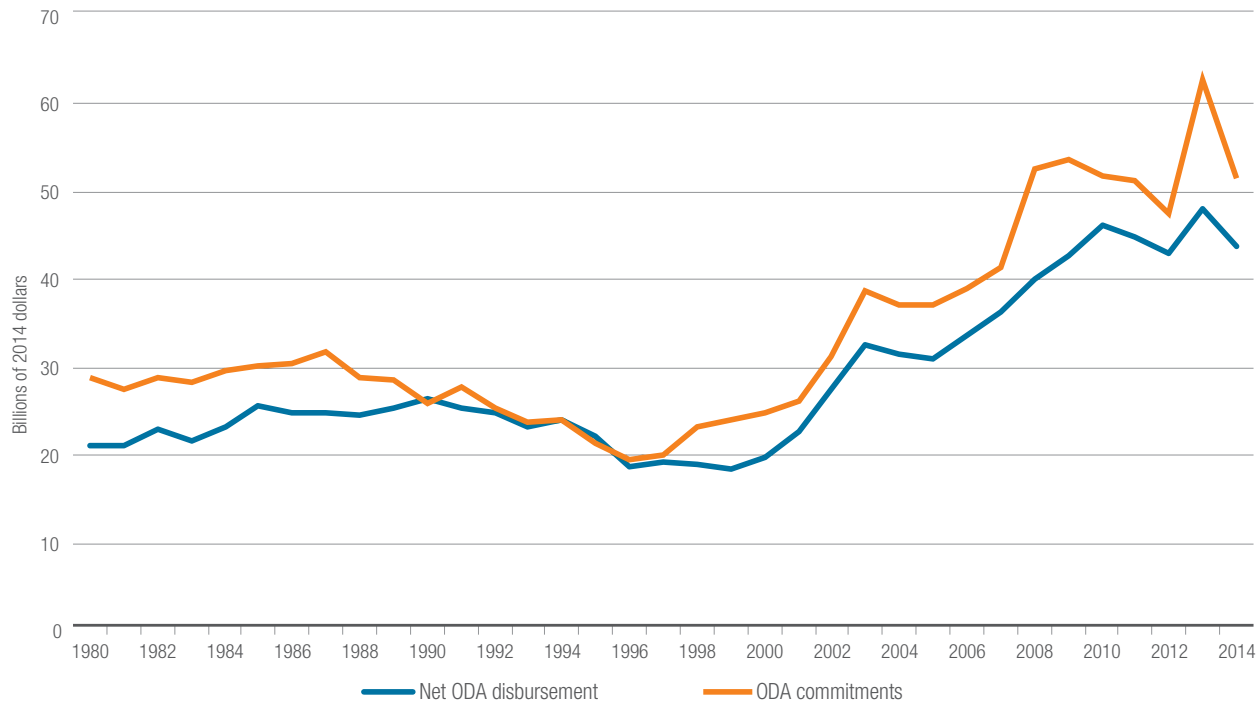
Overall, more than 35 years after the above commitments were first agreed, progress towards stepping up development assistance to the LDCs remains far short of fulfilling them (United Nations, 2015). While net ODA disbursements to LDCs doubled in real terms during the early and mid-2000s, this upward trend ceased following the 2008–2009 financial and economic crisis. Since then, net ODA disbursements to LDCs have stagnated at approximately $45 billion per year at constant 2014 prices (figure 3.1). Relative to recipients' GNI, LDCs' net receipts of ODA fell by more than half between 1992–1994 and 2012–2014, from 12.3 per cent to 5.5 per cent (figure 3.2). Unpredictability and year-to-year fluctuations also continue to be an issue, net disbursements amounting to some 85 per cent of commitments (95 per cent including debt relief).

ODA to LDCs was only half the target level in 2012–2014, a shortfall of $26–50 billion.

Though somewhat improved relative to earlier decades, ODA to LDCs from Development Assistance Committee (DAC) donors was 0.09 per cent of their GNI during the 2012–2014 period, including both bilateral aid and their imputed shares of multilateral aid.[6] This is only half of the 0.15–0.20 per cent target, which, under the 1981 Substantial New Programme of Action, donors were to achieve at the end of the 1980s. Only seven DAC donors (Denmark, Finland, Ireland, Norway, Luxembourg, Sweden and the United Kingdom of Great Britain and Northern Ireland) met the targets over the 2012–2014 period (figure 3.3). This translates into an annual delivery gap of between $26 billion and $50 billion at constant 2014 prices, a shortfall that has been increasing since 2010 (figure 3.4). Moreover, a preliminary assessment by the Organisation for Economic Co-operation and Development (OECD), based on country programmable aid (OECD, 2015), indicates a bleak outlook for aid globally until 2018.

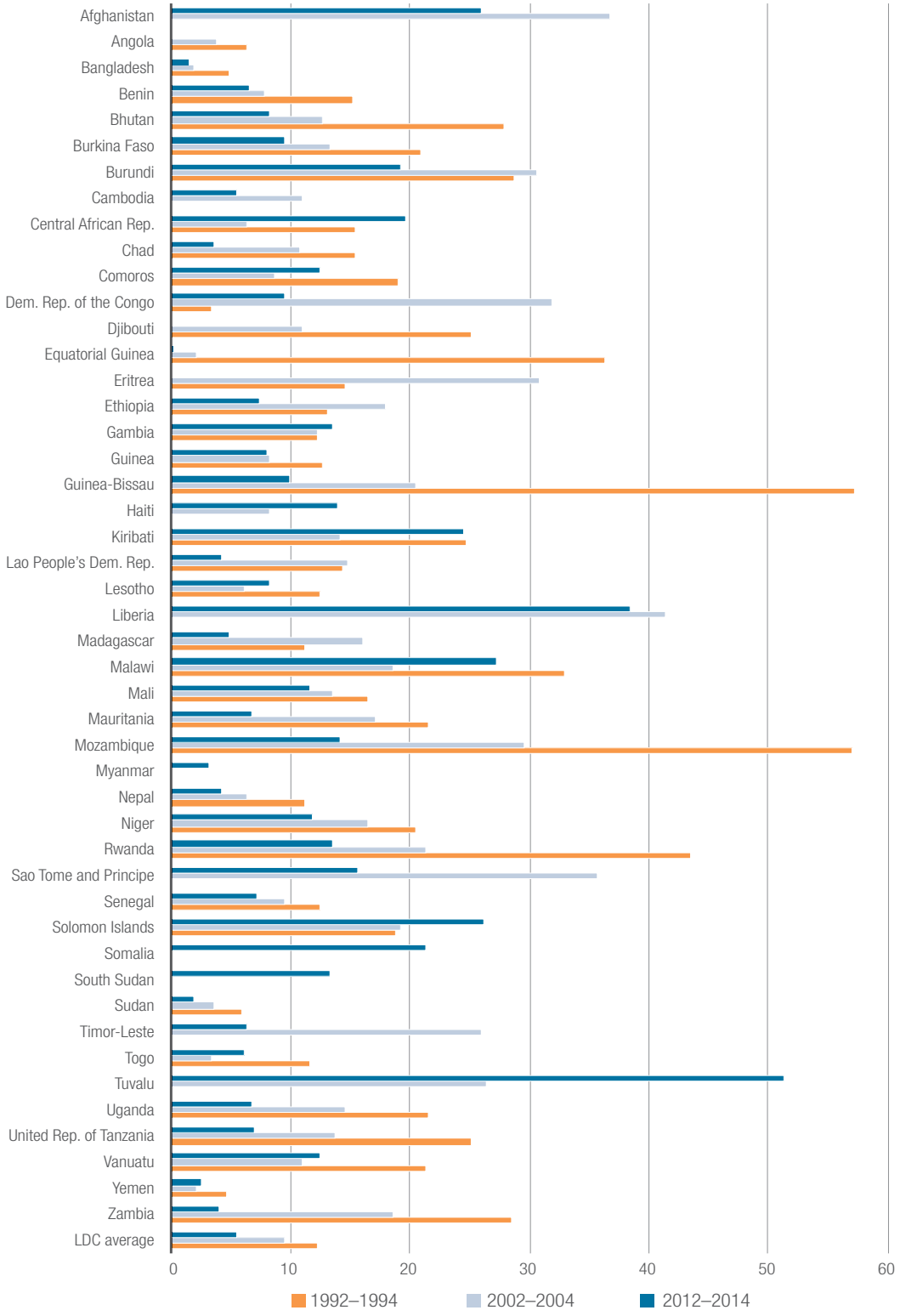
Given the overall shortfall of ODA to LDCs, its concentration in a few countries also raises potential concerns, especially as beneficiary countries' needs are not

Figure 3.1. ODA commitments and net disbursements to LDCs
(Billions of 2014 dollars)



Source: UNCTAD secretariat calculations, based on data from the OECD, International Development Statistics database (https://www.oecd.org/development/stats/idsonline.htm) (accessed September 2016).

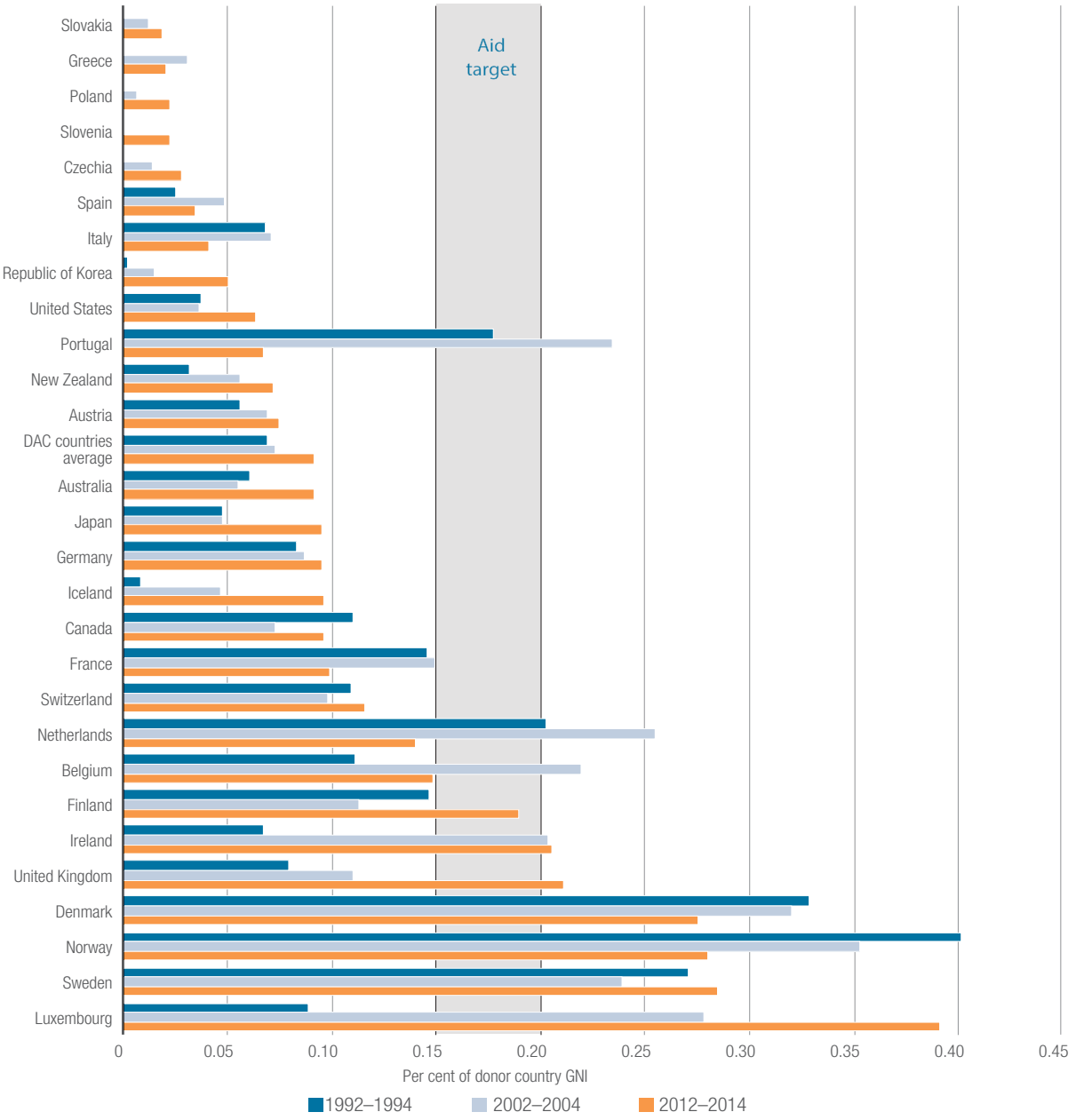
Figure 3.2. Net ODA received as share of recipient country's GNI



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators) (accessed September 2016).

always the decisive factor in explaining aid allocations (Alesina and Dollar, 2000; Dollar and Levin, 2006; Mishra et al., 2012). Around half of all ODA to LDCs goes to just eight countries: Afghanistan, Bangladesh, the Democratic Republic of the Congo, Ethiopia, Mozambique, Myanmar, Uganda and the United Republic of Tanzania.

Figure 3.3. Net ODA to LDCs from individual DAC member countries, 1992–2014 (selected years)



Source: UNCTAD secretariat calculations, based on data from the OECD, International Development Statistics database (https://www.oecd.org/development/stats/ idsonline.htm); and the UNdata database (http://data.un.org/) (accessed September 2016).

Notes: Net disbursements including imputed flows through multilateral channels. Donor countries in ascending order of the ODA to GNI ratio in 2012–2014.

The effectiveness of ODA in promoting structural transformation and productive capacities has also been weakened in recent years by a shift in allocations from economic infrastructure and productive sectors towards social sectors, notably health and education. It is noteworthy in this context that the proportion of ODA allocated to economic infrastructure and productive sectors has been substantially above the average for LDCs in all three of the most recent graduates (Cabo Verde, Maldives and Samoa), but is lower than the average in comparable small-island LDCs such as the Comoros, Sao Tome and Principe, and Solomon Islands (box 3.1).

Eight countries account for half of all ODA to LDCs.

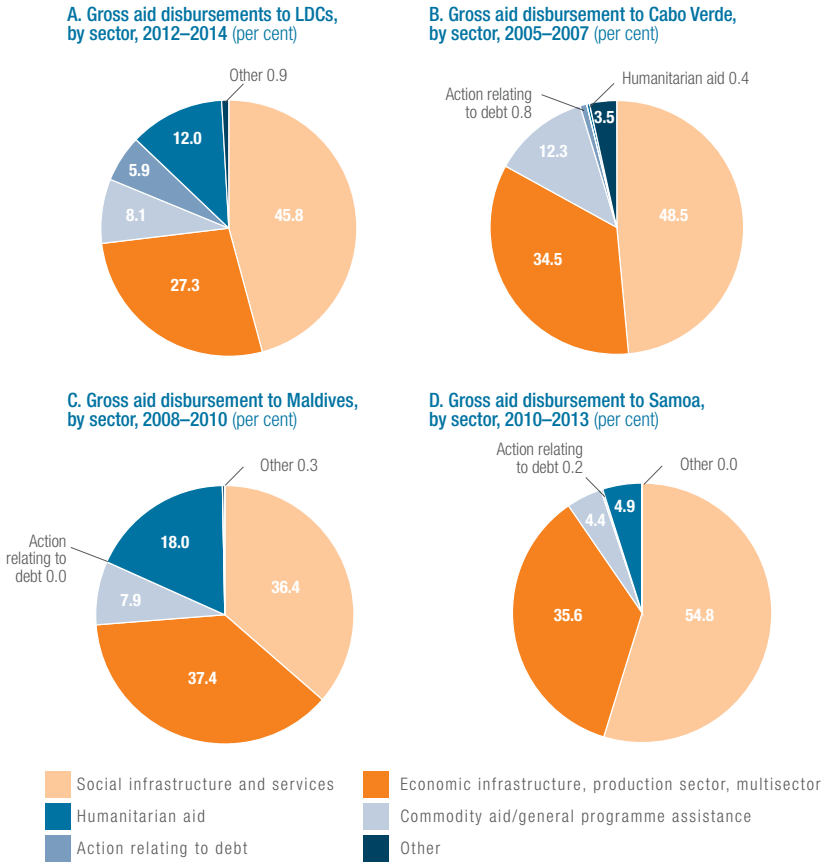
Box 3.1. Sectoral aid allocation in LDC graduates

The governments of the countries that have graduated to date have proactively engaged development partners, not only to mobilize financial support, but also to ensure that ODA is closely aligned with their development priorities, thereby retaining ownership of their development agenda (section F). In all four cases, development of productive capacities has also played a fundamental role in their development strategies.

In the case of the three most recent graduates (Cabo Verde, Maldives and Samoa), this can be seen in the sectoral allocation of their ODA receipts prior to their graduation (box figure 3.1). (Data for Botswana are unavailable for the relevant period.) To smooth out yearly fluctuations, sectoral allocations are averaged over the three years preceding each country's graduation.

In all three of these countries, ODA disbursements for economic infrastructure and productive sectors accounted for between 34.5 per cent and 37.4 per cent in the three years preceding their graduation, substantially higher than the figure for LDCs as a whole (27.4 per cent in 2012–2014, the latest period for which data are available). The proportion is typically still lower in comparable SIDS LDCs such as the Comoros, Sao Tome and Principe and Solomon Islands. While such a comparison can only be illustrative, it corroborates the finding of the country case studies conducted for this Report (Enari 2016; Lui 2016; Mogae 2016; Resende dos Santos 2016) that development of productive capacities represented a major pillar of these countries' paths towards graduation.

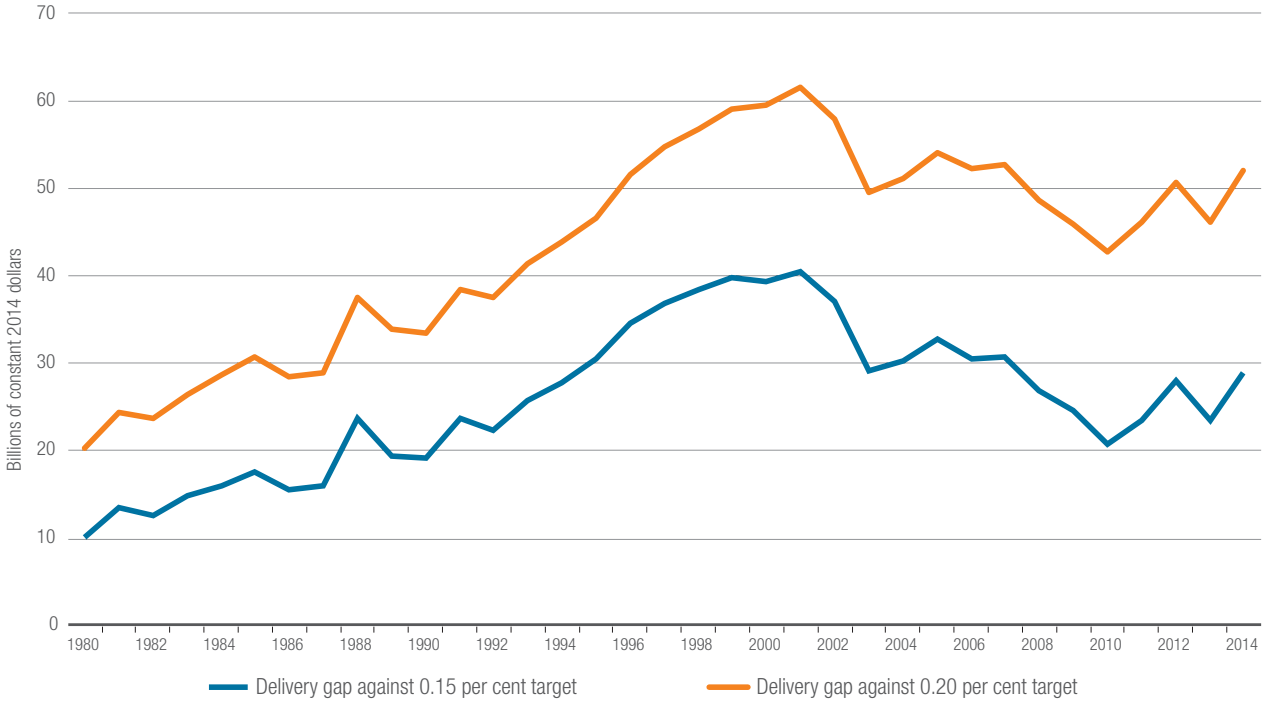
Box figure 3.1. Sectoral composition of aid disbursements, present LDC total and LDC graduates before graduation



Source: UNCTAD secretariat calculations, based on data from the OECD, International Development Statistics database (https://www.oecd.org/development/stats/idsonline.htm) (accessed September 2016).

Notes: Given that OECD-Creditor Reporting System data are annual, for the purpose of this analysis Cabo Verde, Maldives and Samoa are considered graduated respectively at the beginning of 2008, 2011 and 2014. No pre-graduation data are available in the case of Botswana.

Figure 3.4. Net ODA to LDCs: Annual delivery gap vis-à-vis United Nations targets for DAC donors



Source: UNCTAD secretariat calculation, based on data from the OECD, International Development Statistics database (https://www.oecd.org/development/stats/idsonline.htm) (accessed September 2016).

2. Official development assistance modalities

Two further finance-related ISMs pertain to the modalities of aid rather than its magnitude. In 1978, the OECD's Recommendation on Terms and Conditions of Aid stipulated that ODA to LDCs "should be essentially in the form of grants and, as a minimum, the average grant element of all commitments from a given donor should either be at least 86 per cent to each least developed country over a period of three years, or at least 90 per cent annually for the least developed countries as a group" (OECD, 1978: para. 8).

Between the 1990s and the early 2000s the proportion of grants in ODA commitments increased from around 80 per cent to more than 95 per cent.

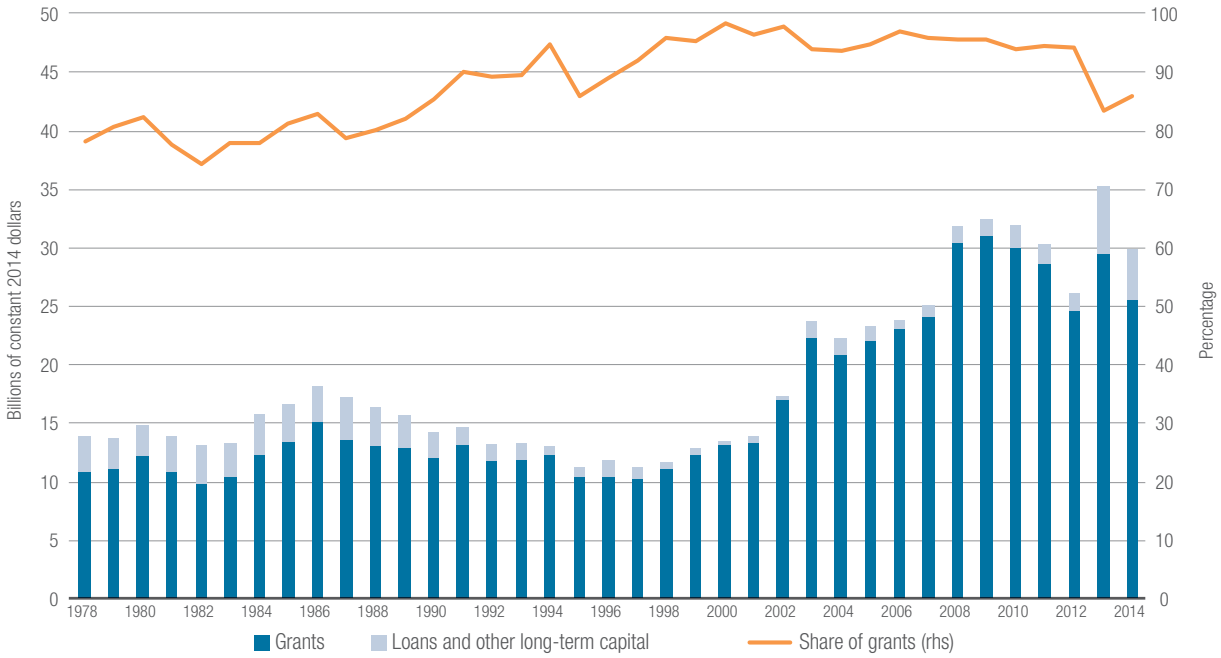
While a full assessment of the fulfilment of this commitment is beyond the scope of this Report, as it would be both complex and data-intensive,[7] a broader assessment indicates some progress between the 1990s and the early 2000s, when the proportion of grants in ODA commitments increased from around 80 per cent to more than 95 per cent. However, the last two years for which data are available have witnessed a partial reversal of this improvement, grants falling back to 85 per cent of the total (figure 3.5).

This increase in the proportion of grants in total ODA commitments remains when non-DAC donors (which do not necessarily abide by OECD recommendations) are included, although this also reduces the share of grants throughout the period, reflecting the greater use of loans by other donors, notably multilateral agencies.

The last two years for which data are available have witnessed a partial reversal of this improvement.

The second finance-related ISM pertaining to ODA modalities stems from the 2001 DAC Recommendation on Untying Official Development Assistance to the Least Developed Countries, and was also enshrined in the 2005 Paris Declaration on Aid Effectiveness (Paris Declaration) (OECD, 2008: para. 31). Like other aid effectiveness commitments, however, progress in this regard has been uneven. At the global level, only one of the 13 targets established for 2010, that for coordination of technical cooperation, was met, and only by a narrow margin (OECD, 2012).

Figure 3.5. ODA commitments to LDCs by DAC donors, by aid type



Source: UNCTAD secretariat calculations, based on data from the OECD, International Development Statistics database (https://www.oecd.org/development/stats/idsonline.htm) (accessed September 2016).

The modest aspiration of the Paris Declaration "to continue to make progress" (OECD, 2008: para. 31) in untying ODA to LDCs is no exception to this limited progress: between 2010 and 2012, the proportion of ODA that was untied rose in only 12 of 21 LDCs for which data are available, while falling in nine. The proportion of untied aid in 2012 was below 90 per cent in nine of the LDCs for which data are available (Bangladesh, Cambodia, the Democratic Republic of the Congo, Ethiopia, Madagascar, Mozambique, Senegal, the Sudan and the United Republic of Tanzania), and as low as 76 per cent in Bangladesh (table 3.2).

The UNFCCC recognizes LDCs' need for financial and technological support for climate change adaptation.

3. Climate finance

Climate change is a critical development challenge for developing countries, and especially LDCs. It can impose major economic, environmental and social costs, including on production and trade, particularly in a context of limited adaptive capacities. It is therefore essential to mainstream climate change adaptation and mitigation[8] fully in development strategies.

LDCs' access to climate finance remains limited.

Adequate international financial support is essential to meeting this challenge. The necessity of financial and technological support to LDCs to adapt to climate change was recognized under para. 9 of article 4 of the UNFCCC, which mandates Parties to the Convention to "take full account of the specific needs and special situations of the least developed countries in their actions with regard to funding and transfer of technology". However, while various funds have been established to provide finance for climate adaptation, accessing them remains time-consuming and complicated even for ODCs (Uprety, 2015). For LDCs, access is further impaired by their limited technical and administrative capacities.

This is partly a result of the proliferation of funds and mechanisms devoted to climate finance. The OECD Accra Agenda for Action included a clear undertaking that "As new global challenges emerge, donors will ensure that existing channels for aid delivery are used and, if necessary, strengthened before creating separate

Table 3.2. ODA from OECD DAC member countries to LDCs reported as untied

	Total bilateral aid as reported to the DAC, 2012*	Untied aid, 2012	2005 (for reference**)	2010 (for reference)	2012
	(Million dollars)		*(Percentage of untied aid)*		
Bangladesh	1 207.2	917.1	89	80	76
Benin	365.6	327.7	80	91	90
Burkina Faso	740.5	680.9	89	90	92
Burundi	303.4	275.2	90	93	91
Cambodia	596.8	478.2	85	82	80
Democratic Republic of the Congo	1 765.2	1 558.2	92	81	88
Ethiopia	1 935.2	1 681.5	66	70	87
Kiribati	59.5	57.3		91	96
Lesotho	75.7	70.1		98	93
Madagascar	402.4	333.8		78	83
Malawi	897.9	840.7	97	92	94
Mali	542.6	513.8	97	87	95
Mozambique	1 357.7	1 172.8	95	84	86
Nepal	750.5	696.1		89	93
Niger	629.3	589.1	85	71	94
Rwanda	442.7	399.2	85	92	90
Senegal	719.1	634.6	94	89	88
Sudan	578.8	517.7		78	89
Timor-Leste	311.2	288.6		83	93
Togo	233.3	210.1		96	90
United Republic of Tanzania	1 483.3	1 312.6	97	91	88

Sources:UNCTAD secretariat, based on OECD (2012, 2014), table A.8 and table A.10, respectively.
Notes: * Excludes donor administrative costs and in-donor refugee costs; ** data are taken from OECD (2012).

new channels that risk further fragmentation and complicate coordination at country level" (OECD, 2008: para. 19(c)). In practice, however, the emphasis has been strongly on the creation of new channels and institutions (LDC-specific or otherwise), resulting in further fragmentation. This has been particularly conspicuous in the field of climate finance, which is now characterized by an immensely complex architecture encompassing 29 implementing agencies, 21 multilateral funds and initiatives, and 7 bilateral funds and initiatives (figure 3.6).

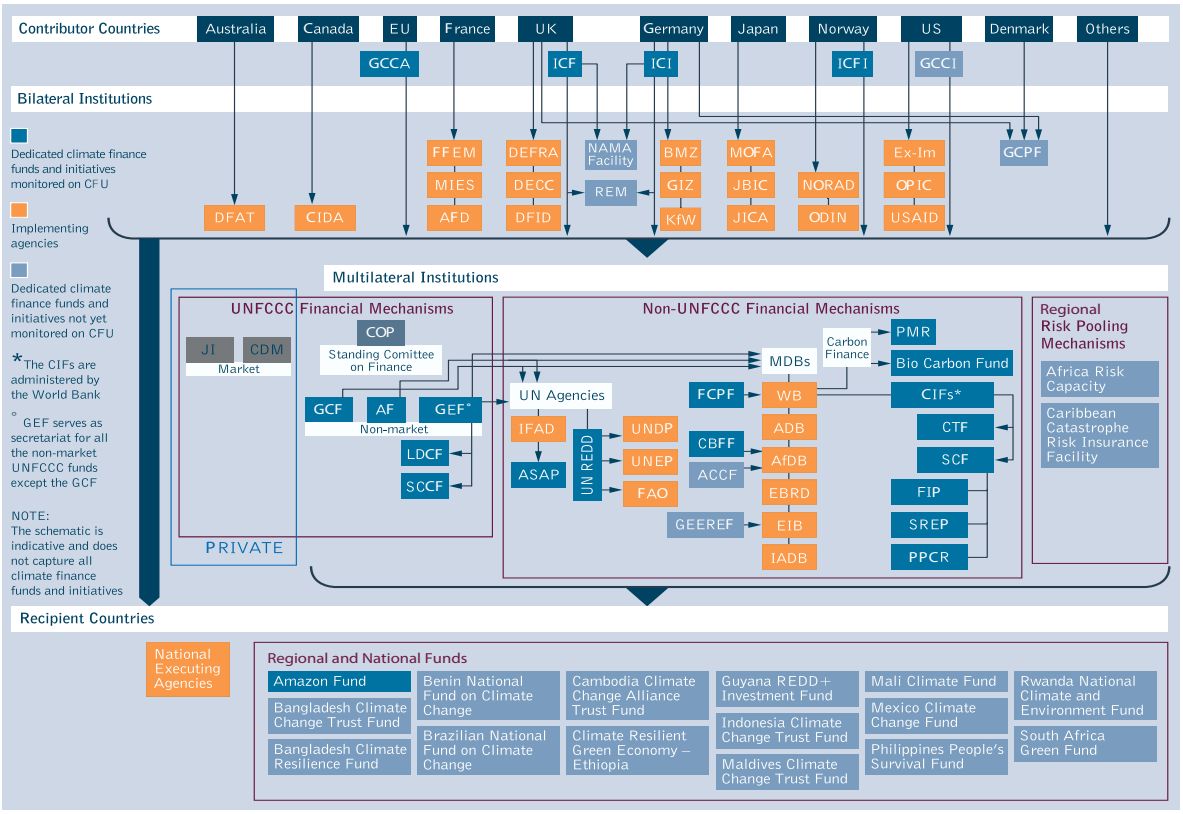
Such complexity adds considerably to the burdens on the limited administrative and technical capacities of LDCs, thereby also limiting and slowing access to the available funding. Such administrative burdens are further increased by often onerous application processes and the very limited progress by donors in fulfilling their commitments under the Paris Declaration to "Implement, where feasible, common arrangements at country level for planning, funding … disbursement, monitoring, evaluating and reporting to government on donor activities and aid flows" (OECD, 2008: para. 32).

The complexity and fragmentation of the climate finance architecture adds to the burdens on LDCs' limited capacities.

This may be a particular obstacle where LDCs must compete for funding with ODCs, which typically face less serious capacity constraints, particularly as a growing number of recipient countries have established dedicated national climate change funds to coordinate funding from multiple sources and align donor interests with national priorities (for instance, Brazil's Amazon Fund and Indonesia's Climate Change Trust Fund).

Multilateral climate funds have broken new ground in helping countries to confront the implications of climate change for development. However, a recent review of their effectiveness (ODI, 2014) found considerable scope for improvement, to increase their flexibility, reduce risk aversion, increase

Figure 3.6. Global climate finance architecture diagram



Implementing Agencies and Institutions	
AfDB	African Development Bank
AFD	French Development Agency
ADB	Asian Development Bank
BMZ	Federal Ministry of Economic Cooperation and Development
CIDA	Canadian International Development Agency
DECC	Department of Energy and Climate Change
DEFRA	Department for Environment, Food and Rural Affairs
DFAT	Department of Foreign Affairs and Trade (Australia)
DFID	Department for International Development
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
Ex-Im	Export-Import Bank of the United States
FAO	Food and Agriculture Organisation
FFEM	French Global Environment Facility
GIZ	German Technical Cooperation
IADB	Inter American Development Bank
IFAD	International Fund for Agricultural Development
JBIC	Japan Bank of International Cooperation
JICA	Japan International Cooperation Agency
KfW	German Development Bank
MIES	Inter-ministerial Taskforce on Climate Change
MOFA	Ministry of Foreign Affairs
NORAD	Norwegian Agency for Development Cooperation
ODIN	Ministry of Foreign Affairs
OPIC	Overseas Private Investment Corporation
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
USAID	US Agency for International Development
WB	World Bank

Multilateral Funds and Initiatives	
AF	Adaptation Fund (GEF acts as secretariat and WB as trustee)
ACCF	Africa Climate Change Fund
ASAP	Adaptation for Smallholder Agriculture Programme
CBFF	Congo Basin Forest Fund (hosted by AfDB)
CDM	Clean Development Mechanism (implemented under the Kyoto Protocol)
CIF	Climate Investment Funds (implemented through WB, ADB, AfDB, EBRD, and IADB)
CTF	Clean Technology Fund (implemented through WB, ADB, AfDB, EBRD, and IADB)
FCPF	Forest Carbon Partnership Facility
FIP	Forest Investment Program (implemented through WB, ADB, AfDB, EBRD, and IADB)
GCCA	Global Climate Change Alliance
GCF	Green Climate Fund
GEF	Global Environment Facility
GEEREF	Global Energy Efficiency and Renewable Energy Fund (hosted by EIB)
JI	Joint Implementation (implemented under the Kyoto Protocol)
LDCF	Least Developed Countries Fund (hosted by the GEF)
PMR	Partnership for Market Readiness
PPCR	Pilot Program on Climate Resilience (implemented through World Bank, ADB, AfDB, EBRD, and IADB)
SCCF	Special Climate Change Fund (hosted by the GEF)
SCF	Strategic Climate Fund (implemented through WB, ADB, AfDB, EBRD, and IADB)
SREP	Scaling Up Renewable Energy Program (implemented through WB, ADB, AfDB, EBRD, and IADB)
UNREDD	United Nations Collaborative Programme on Reducing Emissions from Deforestation and Forest Degradation

Bilateral Funds and Initiatives	
GCCI	Global Climate Change Initiative (US)
GCPF	Global Climate Partnership Fund (Germany, UK and Denmark)
ICF	International Climate Fund (UK)
ICFI	International Climate Forest Initiative (Norway)
ICI	International Climate Initiative (Germany)
NAMA facility	Nationally Appropriate Mitigation Action facility (UK and Germany)
REM	REDD Early Movers (Germany and UK)

Source: UNCTAD secretariat, based on Nakhooda et al. (2015).

transparency in the reporting of their results and impact, lower transaction costs, increase the efficiency of decision-making processes, and strengthen support to the development of national capacity. The review also proposed that funds should allow support to a wider range of stakeholders within countries, and place greater emphasis on appropriate approaches to engage private businesses and investors, as well as developing innovative relationships with financial institutions active in climate-relevant sectors, notably infrastructure.

Of the $7.6 billion approved through climate funds by 2014, half was concentrated in just ten countries, none of which was an LDC, largely reflecting the focus of the Clean Technology Fund on countries with rapidly growing emissions. The pool of funds available for adaptation is more focused on LDCs, but also much smaller. Multilateral funds have approved $1.33 billion of adaptation finance, of which 69 per cent has been for LDCs. Allocations are again concentrated, 43 per cent accruing to the ten largest recipient countries, seven of which are LDCs (Bangladesh, Cambodia, Mozambique, Nepal, the Niger, Yemen and Zambia) while one (Samoa) is a recent graduate from the LDC category. While Bangladesh, Nepal and the Niger have each received more than $110 million to invest in early warning systems and other resilience-enhancing activities, overall climate funding to LDCs remains modest in absolute terms due to the small size of the funds, and not all LDCs have received adaptation finance. Globally, the climate funds need to mobilize financing on a much larger scale, and to focus more on strengthening the underlying policy, regulatory and enabling environments in recipient countries alongside investment activities (ODI, 2014).

There is considerable scope for improvement of multilateral climate funds, which are currently concentrated in a small number of ODCs.

An LDC Fund (LDCF),[9] was established in 2001 under the administration of the Global Environmental Facility (GEF) to meet the particularly acute adaptation needs of LDCs, and to finance the preparation and implementation of country-driven national adaptation programmes of action (NAPAs) identifying priority activities to address their urgent and immediate adaptation needs. In all the LDCs except South Sudan, NAPAs have been prepared and implementation of up to three priority adaptation projects has been started. In 2010, in Cancun, Mexico, Parties to the UNFCCC decided to establish a process to enable LDCs to formulate and implement national adaptation plans — broader and longer-term strategies to identify and address medium and long-term adaptation needs more comprehensively. The national adaptation plan process is intended to be a continuous, progressive and iterative process that follows a country-driven, gender-sensitive, participatory and fully transparent approach (UNFCCC, 2011; Uprety, 2015).

Though more focused on LDCs, finance for adaptation is limited, and much more is needed.

Despite this substantial progress, however, the LDCF continues to have several shortcomings. In particular, its financing remains both inadequate and insecure, reflecting its dependence on voluntary contributions from developed countries. This lack of resources has resulted in the scope of NAPA processes being narrowed from a wide set of priority actions to a handful of the most critical projects (UNCTAD, 2010). Even so, the contributions to the LDCF in the 14 years from its inception to 2015 — estimated at $962 million from 25 countries — are less than one fifth of the estimated cost of implementing even these relatively limited NAPAs across all LDCs (Tenzing et al., 2015). The funding gap faced by the LDCF has become so severe that in October 2014 the GEF declared the LDCF “empty”. While $1.5 billion of further pledges were made to climate funds, including the LDCF, at the COP21 in Paris, it remains to be seen to what extent these pledges will be fulfilled.

LDC Fund financing remains inadequate, insecure and weakly integrated into national development processes.

A further problem is the weak integration of the LDCF’s project-based approach into national development processes, which further limits the potential for more systematic and comprehensive solutions to the LDCs’ adaptation and mitigation needs. The LDCF’s governance structure also affords limited accountability to LDCs and gives them little control over its resources, limiting their negotiating power vis-à-vis the GEF agencies (UNCTAD, 2010). While the LDC Group has called for direct access to LDCF resources, akin to the modality used by the Adaptation Fund under the Kyoto Protocol, this has yet to be fully taken on board by the Parties to the Convention (Tenzing et al., 2015).

In addition to the LDCF, LDCs also in principle have access to the Green Climate Fund (GCF), the Adaptation Fund and the Special Climate Change

Fund. About 50 per cent of the resources of the GCF are to be allocated for adaptation in LDCs, SIDS and African countries. However, many of these pledge-based funds remain seriously underfinanced. There are also obstacles to LDCs accessing funding from these and other sources, including lack of the capabilities required to meet the rigorous multi-tiered accreditation processes necessary to secure direct access to funds such as the GCF and the Adaptation Fund, and the need to secure co-financing (as mandated by the UNFCCC) in order to benefit from GEF funding.

Other pledge-based funds such as the GCF and the SCCF remain seriously under-financed.

While many LDCs have secured funding to implement some of their NAPA-prioritized actions, this has so far remained limited to $900 million (including LDCF funding), compared with an estimated cost of $5 billion for implementing NAPAs in all the LDCs (Uprety, 2015). Moreover, "These costs are also expected to increase as more time passes between the completion of NAPAs and their actual implementation, as well as with the advent of new information on adaptation costs and needs and the identification of new and additional challenges" (Tenzing et al., 2015:2).

As well as issues regarding the scale, availability and predictability of resources, the LDC Group has raised numerous other concerns in relation to the functioning of the LDCF and other climate funds (Tenzing et al., 2015), including:

Funding for priority actions in LDCs has been $900 million, compared with estimated needs of $5 billion.

- The complexity of LDCF procedures, especially in relation to co-financing requirements and identification of baseline (business as usual) and additional (adaptation) costs;
- The constraint imposed by LDCs' limited human and institutional capacities on their ability to access and absorb resources from the GCF, where they need to compete against ODCs;
- Weaknesses in the LDCF's approach to gauging "country ownership" in project proposals;
- Limited LDC negotiating power vis-à-vis GEF agencies;
- The use by GEF agencies of international rather than local consultants;
- The time-consuming process taken to obtain resources for NAPA actions.

A possible approach to addressing these issues, both in the context of climate financing and in development finance more broadly, is outlined in chapter 5. In the longer term, however, major reforms are clearly needed in climate finance to mobilize financing commensurate with the adaptation and mitigation needs of LDCs, to enhance their access to the existing funds, and to increase the effectiveness of delivery.

D. Trade-related international support measures

Multiple shortcomings in trade-related ISMs mean they are inadequate to double LDCs' share of global exports by 2020.

Trade-related ISMs in favour of the LDCs encompass four major areas: support for accession to the World Trade Organization (WTO), preferential market access, other SDT provisions, and trade-related technical assistance. These areas are discussed in turn in the following four subsections, which provide a brief description of the main existing ISMs and a critical assessment of their effectiveness.

Overall, while some trade-related ISMs (especially preferential market access) provide significant benefits to LDCs, their overall impact remains inadequate vis-à-vis the Sustainable Development Goal target 17.11 of doubling LDCs' share of global exports by 2020. Their effectiveness is undermined by several factors, including the narrow scope, vague formulation and non-binding nature of many

existing ISMs (notably best-endeavours clauses in SDT provisions); inadequate commitment by the international community (notably in relation to technical assistance); slow operationalization of new ISMs (as in the case of the services waiver); and other developments in the international trade environment, most importantly tariff reductions leading to preference erosion and the increasing relevance of non-tariff barriers (NTBs) to trade relative to traditional tariff barriers.

1. Accession to the World Trade Organization

Six LDCs acceded to WTO in 2012–2016, and six more are negotiating accession.

The process of WTO accession for LDCs is of considerable significance. Six LDCs acceded to WTO between 2012 and 2016 (Afghanistan, the Lao People's Democratic Republic, Liberia, Samoa, Vanuatu and Yemen) and six more (Bhutan, the Comoros, Equatorial Guinea, Ethiopia, Sao Tome and Principe, and the Sudan) were negotiating their accession at the time of writing.[10] The terms of accession are detailed in a Protocol of Accession negotiated between each acceding country and a working party composed of interested WTO members. The process is long and complex, encompassing negotiations both with the working party on the country's trade regime, and with each of its bilateral partners on its tariff schedule for trade in goods and on offers in trade in services.

WTO members agreed in 2001 "to work to facilitate and accelerate negotiations with acceding LDCs" but progress remains inadequate.

In the 2001 Doha Ministerial Declaration, WTO members agreed "to work to facilitate and accelerate negotiations with acceding LDCs" (WTO, 2001: para. 42). An initial set of guidelines to this end, adopted in December 2002, included provisions to facilitate the negotiation process and to provide technical assistance. These guidelines also called on WTO members to "exercise restraint in seeking concessions and commitments on trade in goods and services from acceding LDCs" (WTO, 2002). As concerns were repeatedly raised on the effectiveness of these provisions (UNCTAD, 2010), they were further strengthened, streamlined and operationalized by a subsequent set of guidelines in 2012. These introduced specific flexibilities for acceding LDCs, including a quantitative benchmark (in terms of binding coverage of a country's tariff structure and the level of bound tariff rates) for market access negotiations on goods; a qualitative benchmark for the bidding process on services; and provisions relating to transparency in the accession process, SDT and transition periods.

While these guidelines represent a significant step towards facilitating LDC accession to the WTO, the process remains skewed against the acceding country. The acceding country receives requests for trade concessions from existing WTO members, both multilaterally and bilaterally, but is not entitled to request tariff concessions or services commitments (Van Grasstek, 2013). As a result, accession has typically entailed significant costs for acceding LDCs, and the process remains long and cumbersome. The accessions of Cambodia (completed in 2004), Nepal (2004), Samoa (2012), Vanuatu (2012), the Lao People's Democratic Republic (2013), Yemen (2014) and Liberia (2016) have taken an average of 13 years to complete. The LDCs that have sought to join the WTO since its creation have faced difficulties in the accession process; and LDCs have complained, both individually and collectively, about the nature of the procedures and the excessive demands that have been made on them in the course of the negotiations (Cortez et al., 2014).

2. Preferential market access

Preferential market access is an important ISM for LDCs.

Preferential market access is one of the most important ISMs available to LDCs (and ODCs), as preferential tariffs on their exports help to offset the higher production and trade costs associated with their structural and geographical handicaps.[11] In the WTO context, the 2001 Doha Ministerial Declaration, which launched the eponymous round of WTO negotiations, included an

explicit commitment "to the objective of duty-free, quota-free market access for products originating from LDCs" (WTO, 2001: para. 42). In 2005, this commitment was reiterated and further clarified by annex F of the Hong Kong Declaration, which urged developed countries, and those developing countries declaring themselves in a position to do so, to "provide duty-free and quota-free market access on a lasting basis, for all products originating from all LDCs … [or] at least 97 per cent of products originating from LDCs, defined at the tariff line level, by 2008 or no later than the start of the implementation period" (WTO, 2005: annex F, 36 (a)(i) and (ii)).

A growing number of developed and developing countries have adopted unilateral preferential schemes for merchandise exports originating from LDCs.

Notwithstanding these clear statements, WTO members have long struggled to achieve a satisfactory agreement on duty-free quota-free (DFQF) market access, and the last Ministerial Declaration to address the subject — the Bali Ministerial Declaration (WTO, 2013a) — weakened previous commitments and also remained in non-binding language.[12] This underlines the importance of LDCs forging a united position on the issue.

The lack of agreement within the WTO has not precluded some significant progress in terms of preferential market access on a unilateral basis. On the contrary, a growing number of developed and developing countries have adopted unilateral preferential schemes for merchandise exports originating from LDCs (see chapter 4). These schemes vary in terms of coverage, exclusion lists and in some cases even beneficiary countries, since some schemes (notably the African Growth and Opportunity Act (AGOA) of the United States of America) are not directly applicable to all LDCs. Developed countries generally provide preferential market access to LDCs through the Generalized System of Preferences (GSP) or through regional and bilateral agreements, while many developing countries have adopted dedicated schemes for this purpose.[13] Among members of the Group of Twenty (G20), average preferential tariff rates on LDC exports are substantially lower in developed than in developing countries (2.6 per cent compared with 8.1 per cent (World Bank, 2015)); but some major developing countries, notably China and India, have granted extensive unilateral preferences to LDCs.[14]

Preferential schemes have contributed to increasing LDC exports, but have not been translated into diversification…

As might be expected, by reducing tariffs faced by LDC exporters, preferential schemes contribute significantly to boosting LDC export revenues (Klasen et al., 2016). This is confirmed by the assessment of the costs to LDCs of losing LDC-specific trade preferences discussed in chapter 4. However, the very limited change in the composition of LDC exports, despite the plethora of preferential schemes, highlights the importance of productive capacities in translating preferential market access into economic diversification as well as higher export revenues.

...due to incomplete product coverage, low preference margins and high compliance costs...

The potential development impact of preferential trade arrangements in this respect is constrained by at least three key factors. First, the potential boost that preferential schemes can provide to LDC exports is limited by their incomplete product coverage, as LDCs' typically high levels of export concentration mean that excluding even a few tariff lines may have a disproportionate effect. For example, an analysis by Bouët and Laborde (2011) of the impacts of alternative potential outcomes for the Doha Development Round estimated that raising DFQF coverage in the same set of preference-granting countries from 97 per cent to 100 per cent would nearly double the export opportunities available to LDCs.

Second, the competitive advantage conferred by preferential tariffs depends on tariff rates relative to competitors — that is, preference margins — more than the absolute rates. In this respect, many primary products at the core of LDC export baskets, most notably minerals and fuels, would be subject to relatively low (and possibly zero) tariffs even on a most-favoured-nation (MFN) basis, so

that preference margins for these products are generally limited.[15] Moreover, the preference margins for LDC exports are gradually eroded over time as the tariff rates faced by ODCs are reduced by liberalization at multilateral, regional and bilateral levels. Nonetheless, LDC preference margins remain significant, at least for some key products in some export markets (ITC, 2010).

Third, preference margins may be limited or offset by the cost of compliance with the scheme's regulations and associated administrative procedures, notably rules of origin. It is widely acknowledged that the combination of low preferential margins and high compliance costs may undermine the appeal of preferential schemes, resulting in a low rate of preference utilization. Rules of origin and other NTBs are of particular importance in this respect in LDCs, as a result of higher compliance costs to potential exporters (reflecting limited supplies of local inputs and/or productive capacities in the case of rules of origin), and weaker institutional frameworks for quality assurance and standard setting. This problem is further exacerbated by the lack of harmonization of rules of origin, which gives rise to different compliance requirements across different export markets, with additional costs and inefficiencies.

...particularly as a result of restrictive rules of origin and other NTBs.

The potential adverse effects of restrictive rules of origin acquire even greater relevance in global value chains, as production processes become progressively more fragmented and trade in intermediate products plays a growing role. In this context, stringent rules of origin are likely to be particularly burdensome in the manufacturing sector (especially apparel and clothing) and in phases of production in the middle of the value chain (that is, adding value to imported raw materials and intermediate products), and much less so for the export of wholly obtained products, such as fuels and unprocessed agricultural commodities (WTO, 2014).

WTO guidelines on rules of origin, if implemented, could help significantly.

At the Ninth WTO Ministerial Conference in December 2013, recognizing the above problems and their detrimental impact on LDCs' integration into global markets, WTO members agreed on a set of guidelines for preferential rules of origin for LDCs, which were further elaborated at the Tenth WTO Ministerial Conference in Nairobi in 2015 (WTO, 2013b; WTO, 2015b, respectively). These guidelines are based only on best-endeavours clauses, and thus not legally binding. However, if fully implemented, they could represent a substantial step towards enhancing the flexibility accorded to LDCs, including by allowing up to 75 per cent of value added to be imported from outside the exporting LDC, facilitating cumulation across LDCs and other beneficiaries of preferential schemes, and simplifying documentation requirements. Since no preference-granting country has yet implemented the Nairobi guidelines, their effectiveness and impact can only be a matter of speculation. However, evidence of other reforms (notably in Canada and the European Union) suggests that introducing additional flexibilities in the rules of origin would be likely to increase the effectiveness of LDC-specific preferential market access by increasing utilization rates.

More than half of LDC exports to major developed country markets would have faced zero tariffs even without preferential market access.

The scope of preferential market access for LDCs can be illustrated by data from the UNCTAD database on GSP utilization on tariff treatment and eligibility in the Quad markets (Canada, the European Union, Japan and the United States). In all four markets, preferential GSP schemes include a more favourable sub-scheme in favour of LDCs, the United States also providing preferential treatment to a number of eligible (LDC and ODC) African countries under AGOA. In 2013 — the latest year for which data are available — the Quad countries accounted for some 40 per cent of LDCs' total merchandise exports: $48 billion imported by the European Union, $23 billion by the United States, $8 billion by Japan and $4 billion by Canada.

On average, as shown in figure 3.7, more than half of these flows were non-dutiable, and would therefore have been subject to zero tariffs even on an MFN basis. Thus, preferential schemes conferred no net gain (that is, a zero preference margin) to beneficiary countries on these exports. Dutiable imports accounted for a variable share of the total, ranging from 29 per cent of total imports in the case of Japan, to around 47 per cent in Canada and the European Union, and 93 per cent in the United States. However, only a subset of the dutiable imports is potentially eligible for preferential treatment ("covered"); and only a subset of covered imports actually receives preferential treatment, as this depends on compliance with rules of origin and other administrative rules governing each preferential scheme.

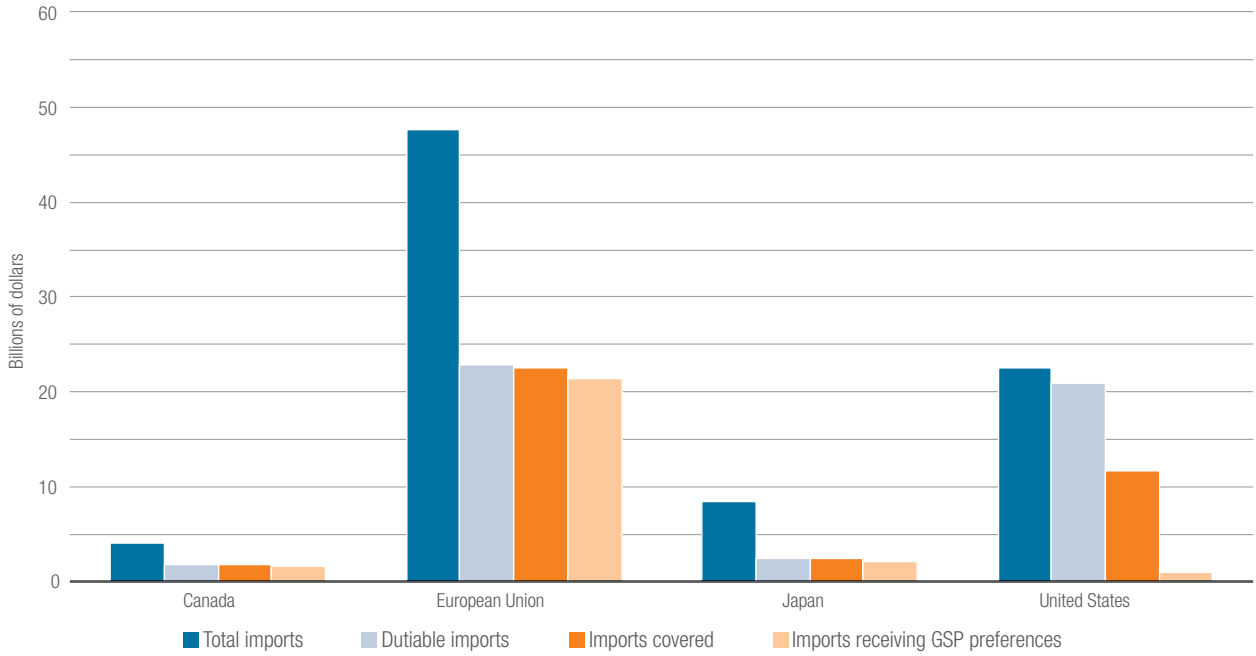
LDCs made greater use of preferences in Canadian and European Union markets when these markets reformed their rules of origin.

Figure 3.8 provides further analysis of the potential coverage and utilization rates of LDC trade preferences in Quad markets.[16] With the exception of the United States, almost all of each Quad country's dutiable imports were covered by GSP preferential treatment, with coverage rates of at least 99 per cent (in line with the provisions of annex F of the Hong Kong Ministerial Declaration). The rates of preference utilization are also relatively high by international standards, ranging between 85 per cent in Japan and 95 per cent in the European Union, with Canada at 89 per cent. In Canada and the European Union, these figures in part reflect reforms of their rules of origin in 2003 and in 2011 respectively, which boosted both utilization rates and import values (WTO, 2014).

In the case of the United States, the situation is complicated by the coexistence of two preferential schemes, GSP and AGOA. Since the latter offers broader coverage and more attractive tariff rates, but with more limited country coverage, it is generally the preferred option for AGOA-eligible African LDCs.[17] This results in a very low rate of utilization for United States GSP preferences, and a higher rate of utilization for AGOA (figure 3.8).

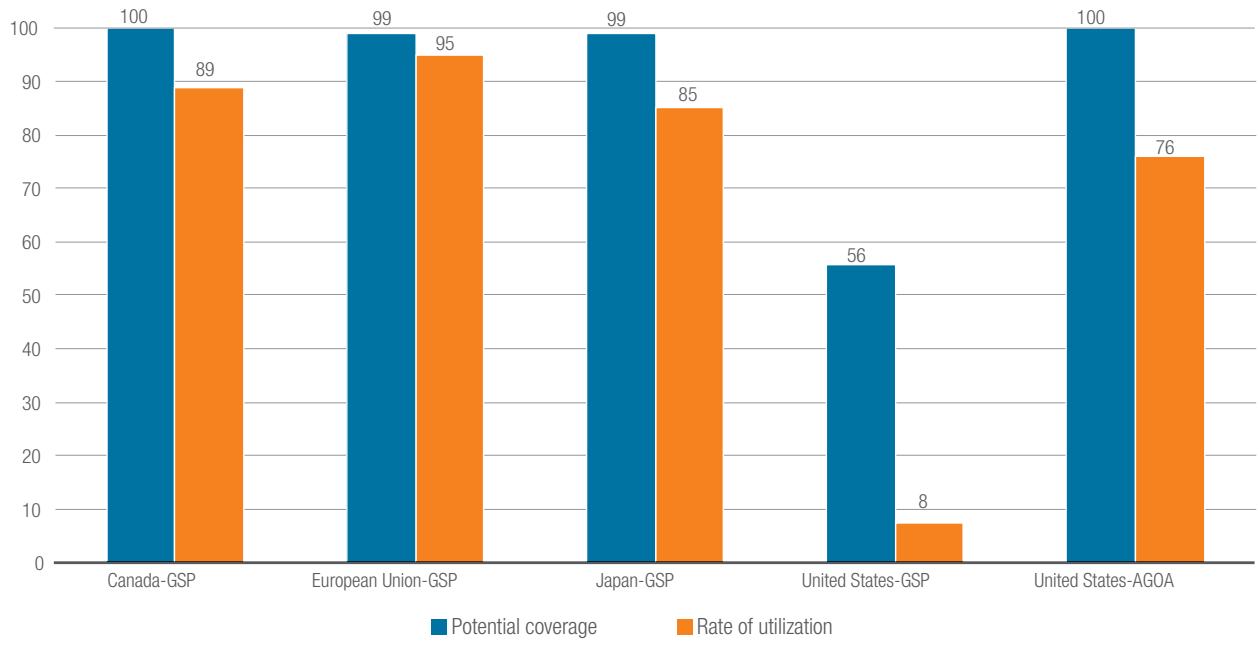
Clearly, such aggregate figures hide considerable heterogeneity across products and sectors, as rules of origin are more critical for manufacturing than for extractive sectors and agricultural raw materials. Nonetheless, despite some undoubted progress in recent years, there remains considerable scope

Figure 3.7. Quad imports originating from LDCs by tariff treatment, 2013



Source: UNCTAD secretariat calculations, based on data from the UNCTAD database on GSP utilization (accessed August 2016).

Figure 3.8. Quad preference coverage and utilization rate, 2013



Source: UNCTAD secretariat calculations, based on data from the UNCTAD database on GSP utilization (accessed August 2016).

to improve the utilization of preferential trade arrangements, and thus their effectiveness. The potential of key LDC exports (for example, apparel and fish products) could be significantly enhanced, supporting efforts to foster economic diversification in LDCs, if the restrictiveness of rules of origin were relaxed along the lines recommended by the Bali and Nairobi Ministerial Declarations.

Considerable scope remains to improve preference utilization, particularly by relaxing rules of origin.

Looking ahead, however, it should be emphasized that the strategic relevance of preferential market access is inevitably set to decline over the long term, for two main reasons. First, preference erosion is set to continue in the future, as the process of trade liberalization continues, and may well be accelerated by the successful conclusion of so-called mega-regional trade agreements. Second, a growing body of research suggests that the trade-restrictive effect of non-tariff measures has, over time, become more relevant than traditional tariff barriers (UNCTAD, 2013). This is particularly the case for LDCs, whose export products are typically subject to numerous non-tariff measures, and whose exporters are likely to face higher compliance costs than those of ODCs (Nicita and Seiermann, 2016). There are also some concerns that the discretionary nature of unilateral preference schemes, which in principle allows them to be withdrawn at any time, introduces an element of unpredictability; and that this could discourage export-oriented investment, notably in value chains with high turnover, such as clothing (CDP secretariat 2012).

Preferential market access will become less important over time, due to preference erosion and the increasing importance of NTBs.

Beyond merchandise trade, the rationale for preferential market access in favour of LDCs has begun to be extended to trade in services, which plays an increasingly important role in a number of LDCs, as well as some LDC graduates. In September 2003, the WTO Council for Trade in Services adopted Modalities for the Special Treatment for Least-Developed Country Members in the Negotiations on Trade in Services. However, it was only eight years later, in December 2011, that trade ministers adopted a waiver enabling developing and developed-country members to grant preferential treatment to services and service suppliers of LDCs in breach of MFN obligations under the General Agreement on Trade in Services (GATS). Initially valid for 15 years, the waiver was extended by four years to the end of 2030 at the 2015 Nairobi Ministerial Conference, where a review process was also established.

Preferential market access has been extended to trade in services…

…but caution is required in interpreting the effects of preferences on services exports.

To date, 23 WTO members,[18] including several developing countries, have notified the WTO of services preferences for LDCs (WTO, 2016b; Rodriguez Mendoza et al., 2016). As the operationalization of the services waiver is still ongoing, it remains unclear to what extent it will translate into meaningful commercial gains or additional opportunities for structural transformation. As discussed in box 3.2, a preliminary assessment of the offers notified to date suggests that preferences may be of some significance, but that some caution is required in their interpretation.

Box 3.2. An early assessment of the services waiver

UNCTAD has commissioned an analysis of the more than 2,000 preferences to LDCs notified to the WTO in the context of the services waiver, to provide a preliminary assessment of their relevance and usefulness. While this analysis indicates that the offers to date are of some significance, it also suggests a need for some caution.

A comparison of the preferences notified under the services waiver with the offers made (to all WTO members) by the countries concerned in the course of the Doha Round negotiations (which started in 2001) found that 12 per cent provided less favourable terms, 40 per cent more favourable terms, and 48 per cent equivalent terms. Since most of the Doha Round offers represented MFN treatment at the time when they were made, and most WTO members have liberalized trade in services further since, this suggests that at least half of the preferences offered to LDCs do not offer actual preferential treatment relative to any other WTO member.

A comparison with the terms of existing preferential trade agreements (PTAs) found that 68 per cent of the preferences notified under the services waiver provided terms equal to those of PTAs, 7 per cent less favourable terms, and 25 per cent more favourable terms. However, these results may have a positive bias, as the PTAs used for comparison were not necessarily the most favourable. The large proportion providing equal terms is likely to be indicative of the use of approaches already used in PTAs as a basis for offers to LDCs.

A third comparison was made with the LDCs' own collective request of July 2014 (WTO, 2014). Here the comparison appears positive, in that 46 per cent of the offers exceeded what was requested, 23 per cent matched the request, and 31 per cent fell short. However, this may be indicative of offers that were not requested because they are of limited relevance to LDCs. For example, two fifths of the offers exceeding the collective request (18 per cent of all offers) represented preferences in mode 2 (consumption abroad), which is of very limited relevance in most sectors (except tourism, health care and education), and is generally subject to very few trade restrictions. The figure is also likely to include offers in sectors and subsectors considered of insufficient economic interest to LDCs to merit inclusion in the request, or in which they are insufficiently competitive to compete successfully even with significant preference margins.

Among other findings of the analysis are:

- Approximately one third of offers concerned mode 4 (movement of natural persons), one quarter mode 3 (commercial presence), and about one fifth each mode 1 (cross-border supply) and mode 2 (consumption abroad);
- The most important sectors for offers were business services, followed by transport and logistics, in both cases predominantly in mode 1 (cross-border supply);
- 86 per cent of offers were in the form of market access, virtually all the remainder being in the form of national treatment.

Source: Rodriguez Mendoza et al. (2016).

3. Other special and differential treatment

The WTO, in its latest (22 September 2016) compilation, lists a total of 145 provisions in the WTO agreements that provide SDT to the LDCs and/or developing countries (or other subgroups of developing countries). This total encompasses a broad range of provisions with distinct objectives (WTO, 2013c):

145 provisions in WTO agreements provide SDT to developing countries, but only 16 are specific to LDCs…

- 15 provisions are aimed at increasing developing countries' trade opportunities;
- 47 require WTO members to safeguard the interests of developing countries;
- 41 entail flexibilities in commitments, actions and use of policy instruments;
- 20 refer to transitional periods;
- 18 relate to technical assistance;
- 16 relate to LDCs.[19]

As can be gauged from table 3.1, these provisions have different degrees of reach and legal impact. Some do no more than reaffirm, in broad terms, the necessity of taking into account the interests and/or needs of developing countries, including LDCs. This is the case, for instance, for article XXXVI of the GATT and of many of the provisions aimed at increasing trade opportunities. Other provisions seek to simplify reporting to WTO bodies. These include, for example, potentially longer periods for trade policy reviews (annex 3 of the Marrakesh Agreement) and simplified procedures for balance-of-payments consultations (article 8 of the Understanding on the Balance-of-Payments Provisions of the GATT). Other SDT provisions call on WTO members to provide assistance to LDCs, notably in developing telecommunications infrastructure and a viable technological base (articles 66.2 and 67 of the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement)), or in complying with technical barriers to trade and sanitary and phytosanitary requirements (articles 11.8 and 12.7 of the Agreement on Technical Barriers to Trade, and articles 9.1 and 9.2 of the Agreement on the Application of Sanitary and Phytosanitary Measures, respectively). While helpful and well-intentioned, these SDT provisions are clearly unlikely to play a decisive role in relation to LDC graduation, owing to their nature — generally related to procedural aspects of the multilateral trading system — and their often vague formulation (notably in terms of commitments for technical assistance).

Some WTO SDT provisions have little concrete impact, and are unlikely to contribute significantly to graduation.

More tangible impacts can in principle be expected from SDT provisions related to transitional periods and flexibilities in commitments, which allow LDCs, on a temporary or a permanent basis, slightly greater policy space than is available to ODCs. A number of SDT provisions grant LDCs extended transitional periods for the implementation of clearly-defined legal obligations, in recognition of their institutional constraints. Some of them are no longer relevant, as the extended implementation periods have now elapsed. However, an important exception is the TRIPS Agreement, whose implementation period for LDCs (under article 66.1) has subsequently been extended (subsection E.1, below).

Extended transitional periods and flexibilities in commitments may have a greater impact…

Measures providing for greater flexibilities in commitments, action and use of policy instruments for LDCs include, for example, article 15.2 of the Agreement on Agriculture, which exempts LDCs from commitments to reduce tariffs and subsidies. Similarly, LDCs are exempted from the prohibition of subsidies contingent on export performance under article 27.2 and annex VII of the Agreement on Subsidies and Countervailing Measures. However, the ability of LDCs to take advantage of these flexibilities is seriously constrained by their lack of financial resources for such subsidies.

…but LDCs' ability to make use of some flexibilities is limited by their financial and institutional constraints.

Although the Trade Facilitation Agreement has not yet entered into force it contains an innovative form of SDT. Section II of the Agreement allows LDCs, on an individual basis, to group some of the relevant commitments into three categories to be notified to the Trade Facilitation Committee at the WTO:

- Category A: to be implemented upon entry into force of the agreement;
- Category B: to be implemented after a transitional period;
- Category C: to be implemented after a transitional period, contingent on the provision of assistance and support to capacity-building.[20]

Many SDT provisions amount to mere "best endeavours" language or vague principles.

Notwithstanding the substantial number of SDT provisions, their overall impact is circumscribed by their relatively narrow scope. They are thus insufficient either to improve the terms of LDC integration into the global market decisively or to provide substantial support to their progress towards graduation. A first concern in this regard stems from the limitation of many SDT provisions to vague principles or “best-endeavours” language, so that their practical effect depends on the goodwill of other WTO members, rendering their implementation

unreliable and unpredictable. Examples include article 24.2 of the Rules and Procedures Governing the Settlement of Disputes, under which WTO members are to "exercise due restraint in raising matters" involving an LDC. While no LDC has yet been a defendant in a dispute settlement case, such vague language does little to enlarge LDCs' policy space. Another such provision is article IV para. 3 of the GATS, which states that "Particular account shall be taken of the serious difficulty of the least-developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs".

The overall impact of SDT provisions is limited by their narrow scope and often limited specificity.

A second factor undermining the usefulness of SDT provisions is their uneven utilization, partly reflecting a lack of awareness and technical knowledge on the part of LDCs (UNCTAD, 2010; WTO, 2013c). These elements are critical, as the utilization of many ISMs is contingent on appropriate legal action within the WTO by the LDC concerned. A report by the CDP secretariat (2012), based on survey responses from 18 LDC WTO members, found wide differences in knowledge of specific SDT provisions and related procedures among LDCs, and greater benefits to those countries with greater awareness. This underlines the need for enhanced technical assistance and capacity-development efforts to address institutional bottlenecks in LDCs and support their full and active participation in the multilateral trading system, including through full and appropriate use of the available SDT provisions. Financial constraints are also critical. As recognized in the findings of the CDP survey, SDT provisions are likely to remain ineffectual unless LDC governments are able to mobilize adequate financial resources to make full use of the policy space they afford.

The effectiveness of SDT provisions will remain limited in the absence of productive-capacity development.

More broadly, these considerations highlight the inevitable limitations to the effectiveness of SDT provisions in the absence of a broader process of productive-capacity development. Addressing supply-side constraints is the main rationale behind the Aid-for-Trade initiative, including trade-related technical assistance, which is discussed in the next subsection.

4. Trade-related technical assistance

The international community has devoted increasing attention and resources to trade-related technical assistance — an implicit recognition of the structural constraints faced by LDCs in harnessing trade and leveraging trade-related ISMs for sustainable development. This has resulted in efforts to build LDC trade capacities, including by addressing supply-side constraints, and to promote a more conducive policy framework to mainstream trade into LDC development strategies. The Aid-for-Trade initiative thus has a critical role for LDCs, and, though not specific to LDCs, it has paid increasing attention to their needs. While mentioned as a "valuable complement" to the Doha Round in the 2005 Hong Kong Ministerial Declaration of the WTO (para. 57), the initiative has been progressively decoupled from the Doha negotiations (Hallaert, 2012).

The Aid-for-Trade initiative has a critical role for LDCs and the EIF is of particular relevance.

Of particular relevance in the context of trade-related technical assistance is the LDC-specific EIF, a multi-donor programme involving six core partner agencies (the International Monetary Fund, the International Trade Centre, UNCTAD, the United Nations Development Programme, the World Bank and WTO) established at the WTO in 1997, and subsequently reviewed in 2005. The EIF's support to LDCs focuses on three key objectives:

- Mainstreaming trade into national development strategies;
- Establishing structures to coordinate the delivery of trade-related technical assistance;
- Building capacity to trade, including by addressing critical supplyside constraints.

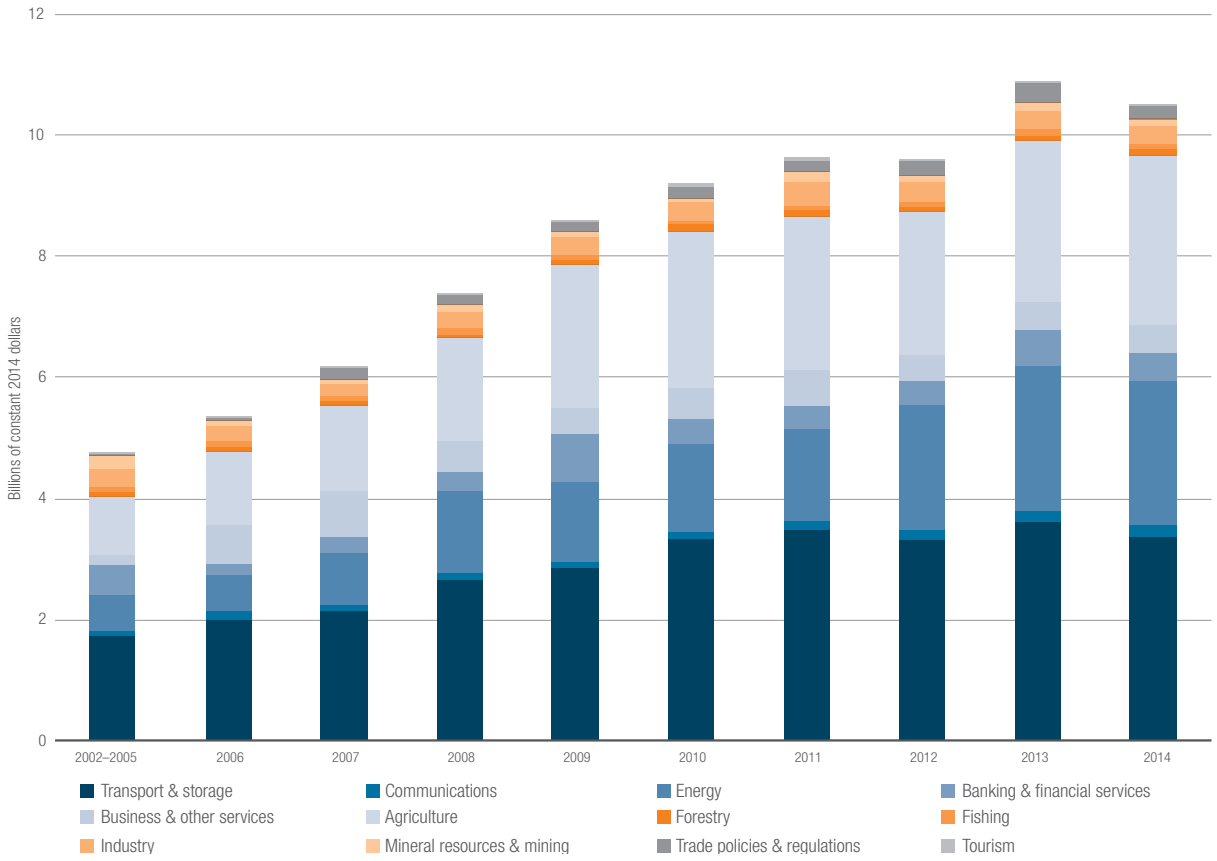
The EIF has also assisted LDCs in the WTO accession process, through analysis of accession-related issues in their diagnostic trade integration studies and support to their participation in accession-related meetings.

Several other international agencies also provide trade capacity-building activities for LDCs, including UNCTAD, relevant United Nations regional commissions and the CDP secretariat. LDCs are also accorded particular priority in the delivery of WTO trade-related technical assistance activities, and on average benefit from more than 40 per cent of such activities (WTO, 2016). LDCs are also entitled to participate in three national training and technical assistance activities per year, in addition to regional courses, as against two for ODCs (WTO, 2015c).

Aid for Trade is part of ODA, raising concerns about its additionality.

It should be noted that, conceptually, Aid for Trade largely overlaps with ODA, and potentially with other forms of financial ISMs discussed in earlier sections of this chapter. Indeed, Aid for Trade is defined as the subset of ODA provided for programmes and projects that are "explicitly identified as trade-related priorities in the recipient country's national development strategies" (WTO, 2006:2).[21] This overlap is also apparent in the sectoral composition of Aid for Trade to LDCs, the overwhelming majority of which is devoted to transport, energy and agriculture (figure 3.9). While this emphasis is certainly warranted (and closely aligned with UNCTAD's traditional focus on productive capacities), the overlap between Aid for Trade and broader definitions of ODA raises some concerns in relation to the additionality of support mobilized under the Aid-for-Trade initiative.

Figure 3.9. Aid for Trade disbursements to LDCs by broad sector (all donors)



Source: UNCTAD secretariat calculations, based on data from the OECD, Creditor Reporting System database (http://www.oecd.org/dac/aft/aid-for-tradestatisticalqueries.htm) (accessed September 2016).

The IPoA and the 2030 Agenda have reaffirmed the importance of Aid for Trade to LDCs.

The continuing relevance of trade-related technical assistance is explicitly recognized in para. 66.3(e) of the IPoA, which calls on development partners to "Implement effective trade-related technical assistance and capacity-building to LDCs on a priority basis, including by enhancing the share of assistance to least developed countries for Aid for Trade and support for the Enhanced Integrated Framework, as appropriate". The importance of Aid for Trade, and of the EIF in particular, is also reaffirmed explicitly by Goal 8.a of the 2030 Agenda, to "Increase Aid for Trade support for developing countries, in particular least developed countries, including through the Enhanced Integrated Framework for Trade-Related Technical Assistance".

Since Aid for Trade is thus largely encompassed within ODA, which is discussed in section C, this subsection focuses on the extent of progress towards these more specific objectives.

While Aid for Trade has doubled in real terms, the share allocated to LDCs has not expanded.

As shown in table 3.3, the total amount of financial resources available under the Aid-for-Trade initiative has approximately doubled in real terms since 2005, both for developing countries as a whole and for LDCs, and in terms of both commitments and disbursements. As for ODA in general, however, there tends to be a significant gap between commitments and disbursements, the latter being more than 40 per cent greater than the former in the 2012–2014 period (UNECA, 2013). However, despite the doubling of Aid for Trade in real terms, there is little evidence of an expansion of LDCs' share of the total, as called for in the IPoA. Over the period as a whole, LDCs have accounted for an average of 29 per cent of total Aid-for-Trade commitments and 27 per cent of disbursements (with some year-to-year variation). In 2014, the last year for which data are available, the share of LDCs in total Aid-for-Trade disbursements fell to 25 per cent, the lowest level for at least a decade.

While support for trade policy and regulations represents only 2–3 per cent of total Aid for Trade, it is of particular importance to LDCs because of their limited institutional capacities. In this area, real disbursements to LDCs have increased substantially since 2005, at an average rate of 16.8 per cent per year, although this partly reflects the very low base, and growth was strongly concentrated at the beginning of the period and near the end (2005–2007 and 2011–2013). While their share in total disbursements increased strongly between 2005 and 2007, it has since fluctuated widely within a band between 16 per cent and 26

Table 3.3. Aid for Trade to LDCs and other developing countries
(Billions of constant 2014 dollars)

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Aid for Trade											
Total developing countries	Commitments	26 792	27 614	30 430	40 147	41 142	43 539	43 515	52 371	56 185	54 447
	Disbursements	19 968	20 895	22 807	26 179	29 286	32 428	36 197	37 587	40 582	42 436
LDCs	Commitments	8 289	7 363	9 597	11 448	12 638	13 395	13 156	12 304	18 442	14 429
	Disbursements	5 552	5 366	6 161	7 379	8 607	9 212	9 652	9 625	10 913	10 532
LDC share of the total (%)	Commitments	31	27	32	29	31	31	30	23	33	27
	Disbursements	28	26	27	28	29	28	27	26	27	25
Of which trade-related policies and regulations											
Total developing countries	Commitments	793	1 218	868	1 127	1 443	1 274	1 362	1 380	1 520	967
	Disbursements	558	565	812	816	878	1 140	1 004	1 139	1 248	1 168
LDCs	Commitments	85	278	98	259	325	204	158	503	320	219
	Disbursements	47	62	179	166	162	187	189	228	320	222
LDC share of the total (%)	Commitments	11	23	11	23	22	16	12	36	21	23
	Disbursements	8	11	22	20	18	16	19	20	26	19

Source: UNCTAD secretariat calculation, based on data from the OECD, Creditor Reporting System database (http://www.oecd.org/dac/aft/aid-for-tradestatisticalqueries.htm) (accessed September 2016).

per cent, and has on average been lower than their share of total Aid-for-Trade disbursements.

Given the difficulties faced by LDCs in leveraging trade-related ISMs in areas such as WTO accession and other SDT provisions, as discussed above, these figures highlight the need to strengthen capacity-development efforts in the area of trade policy. As demonstrated by the experiences of LDC graduates such as Cabo Verde and Samoa (section F below), EIF support to trade mainstreaming, and thus to strengthening the related institutional framework, is of particular importance.

Support to trade policy and regulations is of particular importance to LDCs, and has grown more strongly.

E. Technology-related international support measures

Innovation and technological change are important parts of the development of productive capacities, together with the accumulation of productive resources and structural change (UNCTAD, 2006: chap. II.1). In the LDCs technological change requires a combination of two factors: technological learning and efforts by domestic economic agents (such as firms, workers and agencies); and, crucially, knowledge transfer from technologically more advanced countries, developed and developing (UNCTAD, 2014b).

Weaknesses in technological learning and technology transfer are limiting progress towards graduation with momentum.

There are important weaknesses in both these areas, limiting progress towards graduation with momentum. Technology flows to LDCs currently occur through market-based mechanisms such as international trade, foreign direct investment (FDI), intellectual property licensing and movement of people (visiting or resident foreign specialists, circular migration and training abroad) (UNCTAD, 2007; UNCTAD, 2012: chap. 4). Progress in technological learning and in building domestic capacity to innovate has been inadequate in many LDCs, limiting their ability to absorb internationally available technologies or to harness them effectively for development (for example, by creating stronger linkages and knowledge flows between more modern and less advanced sectors), and hence the benefits in terms of economic transformation and productive capacities. Consequently, these market-based channels have contributed little to narrowing the knowledge divide between LDCs and more technologically advanced countries (UNCTAD 2010: chap. 3). This has been an important factor underlying the widening technological gap between LDCs and ODCs (chapter 1).

Market-based technology flows have not prevented the widening technological gap between LDCs and ODCs.

Given the central importance of technology to development, these shortcomings highlight the need for effective ISMs in this area. Some measures have been put in place to address these issues, notably ODA allocations for science, technology and innovation (STI) in LDCs and technology transfer provisions in some international agreements. However, their contribution to building technological capabilities in LDCs has as yet been very limited, as shown by the analysis below of the major LDC-specific ISMs in the field of technology.

LDC-specific ISMs in technology have contributed little to building technological capabilities.

1. Aid for science, technology and innovation

STI has not traditionally been a priority for ODA to LDCs. During the era of structural adjustment programmes (starting in different LDCs in the 1980s or 1990s), reductions in domestic funding of STI activities were not compensated by increased donor disbursements. ODA allocations for STI tended to reflect donors' priorities in terms of sectors and activities, rather than being aligned with national priorities (Enos, 1995). This pattern has largely continued.

STI has not been a priority for donors, and aid allocations have been very limited and focused on traditional areas of specialization.

Since the 1990s, as discussed in subsection C.1 above, donors have generally shifted the balance of ODA away from economic and physical infrastructure and productive sectors, and towards social sectors and governance. Support to the development of technological capabilities in LDCs also currently receives very limited aid allocations, STI accounting for only 0.49 per cent of total ODA disbursements in 2012–2014, barely one third even of the small proportion in ODCs (1.44 per cent) (figure 3.10).[22]

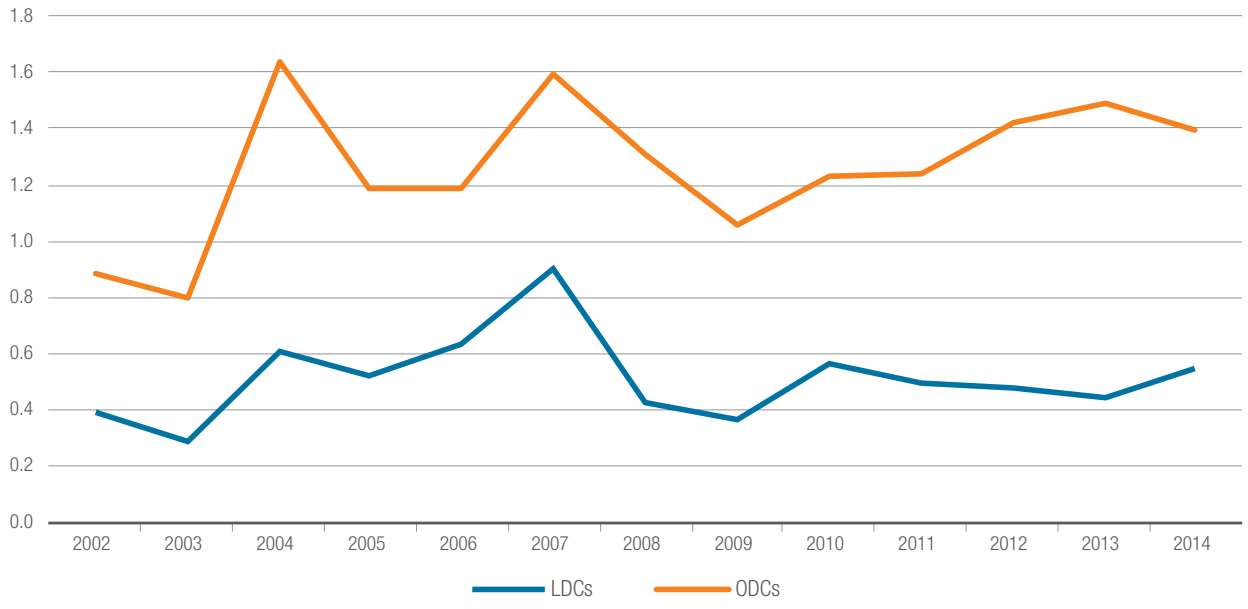
In the case of bilateral ODA for STI, allocations often focus on traditional areas of specialization, notably agriculture (particularly traditional or higher-value cash crops such as cotton, coffee, mango and nuts). Technological improvements in these areas can increase productivity, and the development of non-traditional crops may contribute to diversification within the agricultural sector. However, this sectoral concentration limits the effect of ODA for STI on diversification across the economy as a whole, tending rather to perpetuate historical patterns of production and to reinforce LDCs' current comparative advantage (Foray, 2009).

The WTO TRIPS Agreement includes a longer implementation period for LDCs, now extended to 2021.

2. The Agreement on Trade-related Aspects of Intellectual Property Rights

While several WTO agreements include provisions on the transfer of technology or knowledge, the most important in this respect (as in terms of intellectual property and technology in general) is the TRIPS Agreement. This includes two major SDT provisions specific to LDCs. First, under article 66.1, LDC members are not required to implement the provisions of the Agreement, except for articles 3, 4 and 5 (relating to national treatment and the MFN principle) for 11 years after the entry into force of the WTO agreement (1 January 1995). This waiver has since been extended to July 2021, and to 1 January 2033 in the case of pharmaceutical products.

Figure 3.10. ODA gross disbursement for STI in LDCs and ODCs, 2002–2014
(Percentage of total ODA)



Source: UNCTAD secretariat calculations, based on data from OECD, Creditor Reporting System database (accessed September 2016).
Note: ODA to science, technology and innovation (STI) is the sum of ODA disbursements to Educational research, Medical research, Energy research, Agricultural research, Forestry research, Fishery research, Technological research and development, Environmental research, Research / Scientific institutions.

The second LDC-specific SDT provision relates to technology transfer. The stated objective of the TRIPS Agreement, as defined in its article 7 (emphasis added), is that

> *The protection and enforcement of intellectual property rights should contribute* to the promotion of technological innovation and *to the transfer and dissemination of technology*, to the mutual advantage of producers and users of technological knowledge and *in a manner conducive to social and economic welfare*, and to a balance of rights and obligations.

While TRIPS Article 66.2 imposes legal obligations on developed countries for technology transfer, these are poorly defined…

However, the only major substantive reference to technology transfer or dissemination in the text of the Agreement is in article 66.2,[23] which provides that "Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base".

This text is stronger than a best-endeavours clause, in that it creates a legal obligation for developed country governments to foster the transfer of technology to LDCs; and it has been interpreted as imposing obligations beyond their ODA practices at the time of adoption of the Agreement in 1994. However, the Agreement does not define what constitutes technology transfer, neither does it detail how compliance with obligations under article 66.2 should be monitored (Moon, 2008). At the request of LDCs, the TRIPS Council requested developed countries to report on their activities in respect of their obligations under article 66.2, later (in a decision of February 2003) establishing that they should submit a full report on such activities every three years, with annual updates in the intervening years.

…and few reported activities refer to specific operations of technology transfer.

While it is possible to analyse specific projects, transactions and cases, an overall evaluation of the extent or the effects of technology transfer from developed countries to LDCs is problematic (UNCTAD, 2014b; UNCTAD, 2014c). However, a narrower assessment of the implementation of article 66.2 of the TRIPS Agreement can be made on the basis of developed countries' submissions to the TRIPS Council. An evaluation of such activities reported in submissions between 1999 and 2011 shows that, even with a broad definition of technology transfer, only 11 per cent refer to specific operations of technology transfer to LDCs.

In response to criticisms of limited technology transfer, developed countries emphasize the constraints arising from ownership of the vast majority of the relevant technologies by private sector entities, and the limited ability of governments to force such entities to transfer the technologies that they control. Technology transfer thus depends on efforts to encourage or facilitate actions by companies, rather than direct action by governments themselves (WTO, 2012).

While bilateral assistance projects sometimes transfer public technologies, this is generally incidental to their main purpose.

Technologies originating in public entities of developed countries are sometimes transferred through bilateral assistance projects. In general, however, such projects do not have technology transfer as a primary objective, and the resulting transfers do not constitute a coherent programme of technology transfer. Rather, such technology transfer as occurs is generally incidental to projects with specific technical objectives such as providing clean water, combating particular diseases or eradicating crop pests. Even where development projects focus on STI, intellectual property capacity-building and technology transfer training are typically included only incidentally, if at all.

Article 66.2 of the TRIPS Agreement has thus had very little effect in fostering the adoption of additional incentives for technology transfer to LDCs, making a minimal contribution to their graduation.

Article 67 of the TRIPS Agreement provides that "developed country Members shall provide, on request and on mutually agreed terms and conditions, technical and financial cooperation in favour of developing and least-developed country Members". However, between 2008 and 2012, the number of LDCs benefiting from technical assistance under this article declined dramatically from 25 to 8, while the number of cooperation partners providing such assistance fell from 13 to 5 (UNSGHLP, 2015).

The number of LDCs receiving technical assistance under TRIPS Article 67 fell from 25 to 8 between 2008 and 2012.

3. Climate change-related technology transfer

The transfer of climate-friendly technologies among Parties to the UNFCCC is considered a key means of achieving the Convention's primary objective of stabilizing greenhouse gas emissions. Article 4 para. 9 of the UNFCCC, quoted in section C.3 above in the context of climate finance, requires Parties to take account of LDCs' needs and situations in relation to technology as well as finance.

Under the UNFCCC, there are several mechanisms to monitor whether Parties are taking the actions necessary to facilitate technology transfer. These include national communications and biennial reports, in which developed countries periodically document their implementation of the Convention to the COP. Like other developing countries, LDCs are encouraged (under the 2001 Marrakesh Technology Framework) to submit technology needs assessments (TNAs) identifying their technology needs for mitigation and adaptation, based on a consultative process to identify barriers to technology transfer and measures to address them.

Technology transfer is a key means of stabilizing global greenhouse gas emissions.

In light of the specific structural handicaps of LDCs, the COP has pledged to fund the TNA process in LDCs in full, and funding is provided under the Poznan Strategic Programme on Technology Transfer of the GEF. However, many LDCs are still in the process of finalizing their TNAs, and relatively few have developed technology action plans prescribing measures to address the needs and barriers identified. As of 2015, half of the 48 LDCs had completed a TNA and submitted it to the UNFCCC, but only nine of these TNAs included technology action plans (Craft et al., 2015).

LDC negotiators have repeatedly highlighted the need for the existing technology programmes under the UNFCCC to be strengthened in three major ways: by increasing funding, to provide full support both to the formulation of detailed TNAs and to the implementation of technology activities; by supporting capacity-building for the elaboration of TNAs and proposals for technology-related activities; and by full implementation of the Poznan Strategic Programme on Technology Transfer.

LDCs have repeatedly called for strengthening of technology programmes under the UNFCCC.

In 2010, the COP established the Technology Mechanism, which was subsequently enshrined in article 10 of the 2015 Paris Agreement. This consists of two complementary bodies that work together to promote the development and transfer of climate technologies to developing countries: the Technology Executive Committee and the Climate Technology Centre and Network (CTCN).

A primary function of the CTCN is to respond to requests from national designated entities (NDEs) in developing countries to accelerate technology development and transfer in these countries. NDEs have responsibility for translating TNAs into specific requests to the CTCN so that project proposals can be formulated and implemented. While many LDCs have set up NDEs, technical assistance is needed to build their capacities and allow them to function effectively. As yet, only a few LDCs have sent requests to the CTCN though their NDEs for the formulation of project proposals. However, the CTCN has set up

a Request Incubator Programme to support LDCs in accessing its technical assistance, to strengthen their institutional capacities on climate technologies, and to reinforce their efforts towards technology transfer. At the time of writing, 11 African LDCs and 2 Asian LDCs were participating in the Programme.

Climate-related technologies are also transferred under the Clean Development Mechanism (CDM), established under the 1998 Kyoto Protocol to the UNFCCC. This operates by issuing tradable certified credits for emission-reduction projects in developing countries, which can be purchased by developed countries to meet a part of their emission-reduction targets under the Kyoto Protocol to the UNFCCC. In principle, such projects should use technologies that are not currently available in host countries, and thus entail technology transfer. However, of 4,984 registered and proposed CDM projects in 2010, only 30 per cent claimed to involve technology transfer. Moreover, the majority of CDM projects were in large emerging economies — 1,993 in China, 1,254 in India and 338 in Brazil — while hardly any were in LDCs. By the end of 2012, there were only 12 registered CDM projects in 7 LDCs. The paucity of CDM projects in LDCs partly reflects its primary focus on mitigation rather than adaptation, the use of market-based approaches, and the more favourable balance of risk and return available to private investors in ODCs than in LDCs (Craft et al., 2015). Limited institutional capabilities in LDCs represent a further constraint to their access to the CDM. Thus, while the CDM is an important tool for fostering technology transfer under the UNFCCC, its relevance and benefits to LDCs have remained extremely limited.

Clean Development Mechanism projects are strongly concentrated in ODCs, and relatively few entail technology transfer.

4. The Technology Bank

Recognizing the importance of STI for development and graduation, and the limited progress to date in accelerating technology transfer to LDCs, the IPoA envisaged the establishment of "a Technology Bank and Science, Technology and Information supporting mechanism, dedicated to the least developed countries" (United Nations, 2011: para. 52.1). Four years later, the Addis Ababa Action Agenda aspired to operationalize this proposal fully by 2017, an objective that was later adopted under the 2030 Agenda as target 17.8 of the Sustainable Development Goals.

The United Nations Technology Bank for the Least Developed Countries is expected to consist of two components: the Science, Technology and Innovation-supporting Mechanism and the Intellectual Property Bank. The former is intended to "help LDCs articulate their STI policies and priorities as part of their overall development strategy; assist them in finding and accessing those programmes that are most appropriate to their STI aspirations; and then act as their advocate with other institutional development actors" (UNSGHLP, 2015:8).

A Technology Bank for LDCs is scheduled to become operational in 2017.

The Intellectual Property Bank is to (UNSGHLP, 2015:7):

> [C]reate new opportunities for the dissemination of key technologies. These involve: direct transfers of protected IP — as well as the know-how to implement it — to LDC recipients, including entrepreneurs and SMEs; maximum transfer of technical knowledge through Foreign Direct Investment (FDI), including supporting LDCs in complex contract negotiations; support of IP protection in LDCs; and, training to IP-enforcement officials as well as strengthening IP Offices in LDCs … Ultimately, the IP Bank's goal should be that LDCs beneficially integrate themselves into the worldwide IP system

It is anticipated that the Bank will begin its operations in 2017, in accordance with Sustainable Development Goal target 17.8, and that it will be funded by Member States of the United Nations and other stakeholders on a voluntary basis, with an annual budget in the order of $10 million. The intention is that it should grow progressively over time, building on the experience gained and lessons learned from its work. Possible means of enhancing the effectiveness of the Technology Bank in fulfilling its mandate are discussed in chapter 5.

F. The role of international support measures in past graduation cases

ODA has played a major role in all four past graduation cases...

ODA played a major role in the graduation of all four of the countries that have graduated from LDC status to date. As might be expected, given their small populations (which at the time of graduation varied between 0.2 million and 1.5 million), all four countries had relatively large ODA receipts per capita, averaging $163 in Maldives, $181 in Botswana, $387 in Cabo Verde and $437 in Samoa (at 2013 prices) in the decade prior to their graduation. These figures are between 3.3 and 9.0 times that for LDCs as a whole in 2005–2014.[24]

At least as important as the volume of ODA, however, was the graduates' policy towards their ODA receipts. Botswana and Samoa, in particular, adopted a very proactive role in management of ODA receipts, maintaining clear leadership and ownership of their respective development processes, and ensuring that ODA was clearly oriented towards their own development strategies.

As noted in chapter 2, Botswana's development strategy from the late 1960s was shaped by a planning cycle of five to six years. National development plans were approved by Parliament and enshrined into law, and parliamentary approval was required for any public sector endeavour that did not appear in the current plan. Donors were thus required to direct ODA into projects that had already been recognized in the plan as national priorities. Planning was also integrated into the budgetary cycle, so that projects could not be initiated unless provision had been made for their recurrent costs. This model appears to have been highly effective (Mogae, 2016).

…partly reflecting proactive approaches to aid management, particularly in Botswana and Samoa.

Samoa, likewise, had a reputation for particular effectiveness in coordinating and managing its ODA. The Government was effective in identifying the need for projects and seeking donor assistance in accordance with its broader development strategy; and donors frequently noted the authorities' unusual willingness, not only to articulate the country's needs, but also to reject approaches and individual activities that did not accord with national priorities. This contributed to a much stronger sense of ownership of aid-funded activities than in some nearby countries (Delay, 2005). The aid coordination process was centred on a clear leading role of the Government, and had three main institutional elements:

- Two national committees with overlapping staff, one for coordinating national development planning and one specifically for donor coordination, which integrated donor assistance into the broader national development framework;
- A close relationship between the donor coordination process and a well-developed system of national planning based in the Ministry of Finance;
- A system of sectoral donor meetings, initially in education and health and later extending to other sectors.

The cases of Botswana and Samoa highlight the importance of a proactive and strategic approach to ODA, integrating it effectively into nationally owned and driven development planning processes. In both cases, institutional and human capacity were important factors, as well as strong government leadership of the process. Other factors, at least in Samoa, were stability and continuity of key players in donor coordination, allowing donor confidence and knowledge of donor approaches to be built over time; and the relatively small number of major donors (the Asian Development Bank, Australia, Japan and New Zealand) (Delay, 2005).

ODA also played a major role in Cabo Verde's graduation.

In Cabo Verde, too, ODA played a major role in the development process leading up to graduation. It was an important source of non-debt-creating external financing, and financed major investments in economic and social infrastructure, resulting in infrastructure spending among the highest in Africa at around 15 per cent of gross domestic product (GDP) (Briceño-Garmendia et al., 2011). As well as contributing directly to economic and social development, this also (together with migrants' remittances) permitted a higher level of domestic consumption demand and investment than would have been possible from domestic resources alone. Food aid also played an important role, not only in stabilizing food supply (given the country's high level of food insecurity, drought-induced famine and poverty), but also in generating resources for public works projects in rural areas, through the proceeds of sales of food aid to the population. The resources thus raised were an important instrument for rural development and poverty reduction.

The nature of past graduates' exports has limited the role of trade-related ISMs.

Trade-related ISMs played a more limited role in these countries' progress towards graduation, reflecting the dominance in exports of primary commodities (principally diamonds) in the case of Botswana, and of services (particularly tourism) in Cabo Verde, Maldives and Samoa.

In Maldives, prior to graduation, fish represented more than 98 per cent of merchandise exports, nearly 90 per cent of which was tuna. The fisheries sector also accounted for 5 per cent of GDP and employed 11 per cent of the total workforce. As an LDC, Maldives benefited substantially from preferential access to the European Union and Japanese markets for fish, driving rapid growth in production from the early 1980s. While the main market was Thailand, accounting for 30 per cent of the total, and Sri Lanka accounted for most exports of dried fish, the European Union was the major market for canned fish.

Samoa benefited from ad hoc derogations to a non-LDC-specific preferential trade arrangement with Australia.

A clearer case of a graduating country that has benefited from a preferential trade agreement (PTA) — though not a PTA specific to LDCs — is the development of automobile components manufacture in Samoa for export to Australia under the 1980 South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA). When local content requirements for the Australian motor industry were modified to include content from member countries of the Pacific Islands Forum in the early 1990s, the Japanese company Yazaki relocated a component factory from Australia to Samoa to take advantage of lower wages. However, the continuation of this operation depended on a number of increasingly generous ad hoc derogations of the terms of the SPARTECA provisions, particularly in relation to rules of origin, as value added in Samoa fell below the required 50 per cent soon after the relocation. The benefits to Samoa have been substantial, as the plant employ 950 Samoans, making it the single largest private sector employer in Samoa (Morgan, 2012).

G. The utilization of international support measures by present least developed countries and their perceived usefulness

To provide a more complete picture of ISMs from the perspective of LDCs themselves, the UNCTAD secretariat carried out a survey in 2016 on LDCs' utilization of ISMs and perceptions of their usefulness. Survey questionnaires were sent to LDC government officials (all but one from ministries of trade and industry) and United Nations country economists based in LDCs. These elicited eight responses, all from WTO members in Africa, Asia and the Americas.[25] While the findings cannot be considered statistically significant, due to the small sample size and the limitations inherent in exercises of this nature, they are nonetheless informative, particularly when considered in conjunction with the findings of similar surveys and supporting data (CDP secretariat, 2012; WTO, 2013c).

LDCs' use of SDT in the context of WTO varies widely across agreements and provisions.

The majority of respondents (some 75 per cent) confirmed that their countries had made use of SDT provisions in the context of the WTO, but the extent of reported use varied significantly across agreements and provisions. Respondents singled out preferential market access, flexibilities in commitments, and support extended through the EIF on trade-related matters as the most effective and/or most widely used measures. Conversely, few countries reported having made use of the flexibilities available to the LDCs under the agreements on TRIMs, Technical Barriers to Trade, and the Application of Sanitary and Phytosanitary Measures.[26] Comments by respondents trace the uneven use of the available flexibilities to a variety of causes, ranging from lack of specialized skills and superficial understanding of the agreements to limited involvement of the private sector and poor coordination across different ministries (particularly in relation to notifications to the relevant WTO committees). Lack of funding was also mentioned as one of the main constraints limiting the use of available policy space, notably with respect to export and agricultural subsidies.

LDC officials report continuing difficulties in the WTO accession process.

Questionnaire responses also pointed to continuing difficulties in the accession process, a consideration that resonates with the concerns voiced by those LDCs currently in the process of accession. More generally, budget constraints have long been recognized as a stumbling block to the proactive participation of LDC delegations in WTO activities, their regular presence in relevant committee meetings, and ultimately their negotiating capacities.

Despite some significant improvements since the turn of the century, the quest for development finance remains a key challenge for most LDCs, and 85 per cent of respondents deemed their respective countries' access to such finance insufficient to achieve the IPoA targets by 2020. In this respect, FDI and technical assistance were identified as the areas where the scope for improvement was greatest.

Management of aid flows is seen as having improved, but that of resource rents less so.

The large majority of respondents reported some improvements in terms of aid-management policies, incipient use of innovative sources of development finance, and to some extent increasing involvement in public–private partnerships. However, the findings on the management of resource rents were less encouraging, despite the fact that several of the responding LDCs are members of the Extractive Industries Transparency Initiative (chapter 2, subsection D2(b)). Only about half of the respondents considered that there had been improvements in their respective countries' ability to retain and manage resource rents. This sobering assessment is consistent with the mounting international pressure to tackle illicit financial flows linked to trade mispricing,

which deprive many African fuel and mineral exporters, in particular, of much-needed financial resources (UNECA, 2015; UNCTAD, 2016).

Serious concerns were also raised by all respondents on the effectiveness of ISMs related to technology transfer, notably those under article 66.2 of the TRIPS Agreement. In particular, many responses highlighted the modest overall pace of technology transfer and adoption, and the intrinsic difficulties of tracing successful cases of technology transfer to the existence of the ISMs rather than purely profit-driven private sector investment decisions. While some technical assistance has been delivered for implementation of the TRIPS Agreement, further action is also needed to support the development of comprehensive and coherent STI policy frameworks. The central feature of the development of productive capacities is a progressive increase in the sophistication of the productive base; and this depends on absorptive capacities as well as the transfer of technologies. To be fully effective, technology transfer therefore needs to be accompanied by broader support, to foster the emergence of vibrant innovation systems.

Serious concerns remain about the effectiveness of ISMs related to technology transfer…

Following the Paris Agreement, the overwhelming majority of respondents acknowledged that the needs and priorities of LDCs in relation to climate change adaptation and mitigation were increasingly taken into account by the international community. Beyond this broad acknowledgement, however, "the devil is in the detail". Many LDC respondents lamented the lack of systematic information and technical administrative capacity, which impede access to climate finance. The two greatest concerns in relation to climate finance were the uncertainties surrounding the magnitude of disbursements (as opposed to pledges), and the degree of additionality vis-à-vis development assistance. Officials also underlined the need to strengthen technical assistance for the integration of climate change adaptation and mitigation into national development strategies.

…as well as the magnitude and additionality of climate finance.

Overall, the survey findings suggest that existing ISMs are often perceived as insufficient relative to LDCs' development challenges, while also highlighting the disadvantages LDCs face in using the available flexibilities effectively and in accessing adequate funds and technical assistance as a result of their weak institutional capacities. These findings indicate the need for a two-pronged approach, aimed at:

Efforts to strengthen ISMs need to be complemented by greater capacity development in LDCs.

(a) Scaling up international commitments towards the LDCs, and strengthening the available ISMs in line with the ambitious targets of the IPoA and the Sustainable Development Goals;

(b) Strengthening ongoing capacity development activities in the LDCs, notably in key ministries, to enable these countries to reap the benefits of ISMs more fully.

H. Conclusion

Notwithstanding the inevitable limitations to any assessment of their effectiveness, it seems clear that the existing ISMs are inadequate to the developmental needs of the LDCs, particularly in the context of the IPoA graduation target and the Sustainable Development Goals. This confirms and reinforces the conclusion of *The Least Developed Countries Report 2010* (UNCTAD, 2010). Though many existing ISMs are useful and promising in principle, their effectiveness in practice is often undermined by vague formulation (notably in the case of best-endeavours clauses), inadequate commitment on the part of the international community (notably on ODA), insufficient funding (for example, of climate finance), slow operationalization (for example, of the

Existing ISMs remain inadequate, particularly in light of the IPoA graduation target.

services waiver) and exogenous developments (notably the effects of preference erosion and the increasing importance of NTBs on preferential market access).

ISM effectiveness depends on viable institutional frameworks, alignment with LDCs' needs and adequate funding…

The track record of the most recent initiatives, such as the LDC services waiver and the Technology Bank, highlights the critical dependence of ISM effectiveness on viable institutional frameworks (whose establishment may be time-consuming) and concrete operational mandates aligned with LDCs' needs and developmental interests, as well as adequate funding. In the absence of any of these three elements, even the most laudable initiatives are in danger of becoming little more than symbolic, and may have the unintended consequence of overstretching LDCs' scarce institutional and negotiating capacities in the quest for benefits of limited economic value.

Nonetheless, the experience of past LDC graduates suggests that at least some of the existing ISMs, notably preferential market access and ODA, can play an important role in supporting the graduation process. The findings of the UNCTAD secretariat survey whose results are reported in this chapter appear to confirm that current LDCs consider ISMs to be of some value in this context.

… but also on LDCs' capacity to leverage them strategically in support of their own development strategies.

The effectiveness of ISMs is also influenced by the capacity of individual LDCs to leverage them strategically in pursuit of their own development and graduation agendas. More successful LDCs have capitalized on preferential trade schemes with their key trade partners to support an incipient process of diversification and sophistication, moving progressively into new products embodying greater value addition. Others, however, have failed to translate existing preference margins into opportunities for export diversification into new products or to new markets. Likewise, utilization of trade-related SDT varies widely across LDCs, depending in large part on their awareness and technical capacities, and development of the necessary productive capacities. The experience of past LDC graduates also highlights the importance of proactive aid management policies and strong ownership of a country's development agenda in enhancing aid effectiveness.

The potential contribution of ISMs to graduation highlights the importance of institutional capacities and of countries' ownership of their development strategies.

These considerations underline the critical role of LDCs' institutional capacities, as well as their productive capacities, as determinants of the relevance and effectiveness of ISMs. Institutional capacity constraints need to be taken fully into account in the establishment and design of ISMs to enhance LDCs' informed access to them, including through dissemination of information and technical knowledge, and capacity-building among stakeholders. The examples of the EIF and NAPAs underline the potential impact of combining the establishment of ISMs with the provision of related technical assistance.

The international community could undoubtedly do more to improve the terms of LDCs' integration into the world economy and to deliver on its own commitments to support LDCs' development process through more ambitious and relevant ISMs; but country ownership remains essential to graduation with momentum. ISMs should not dictate a country's graduation strategy, but rather provide a set of instruments to facilitate its implementation. Accordingly, LDCs themselves need to exercise strong leadership of their own development processes, defining their own strategic priorities for structural transformation and harnessing dedicated support for it. Greater policy consistency, on the part both of LDCs and of their development partners, is also essential to ensure that the effectiveness of ISMs is not undermined by external factors, such as the outcome of bilateral and regional arrangements, or unlawful practices such as illicit financial flows.

I. Summary

- There are a growing number of ISMs for LDCs, which vary widely in nature, focus and content. Their relative importance thus differs widely among LDCs according to their structural characteristics and capacities.
- Despite more than doubling in real terms between 2000 and 2010, ODA to LDCs remains only half the target level of 0.15–0.20 per cent of donor GNI to which donors have been committed since the early 1980s, and progress on aid effectiveness commitments remains very uneven.
- While climate finance has increased, the financing of the LDC Fund is inadequate and insecure, and LDCs' access to other funds is limited by the need to compete with better-resourced ODCs.
- Despite WTO members' long-standing commitment to facilitate accession by LDCs, the process remains skewed, and LDCs have continued to face obstacles.
- Preferential market access is one of the most important ISMs for LDCs, and progress in this area has boosted their export revenues significantly; but the benefits are limited by exclusions of sensitive products, small preference margins for non-agricultural commodities, preference erosion and restrictive rules of origin.
- While trade preferences for LDCs have been extended to services under the WTO services waiver, and a substantial number of preferences have been notified, it is too early to assess their significance.
- SDT provisions under WTO agreements vary widely, from non-binding "best-endeavours" language to extended implementation periods and exemptions from commitments; but their overall impact is limited by their relatively narrow scope and obstacles to their utilization.
- Aid-for-Trade disbursements to LDCs have doubled in real terms since 2005, but the IPoA target of increasing their share of ODA has not been fulfilled.
- Technology-related ISMs have had little impact in building LDC technological capacities, but may be enhanced by the operationalization of the Technology Bank, scheduled to begin in 2017.
- In the past graduation cases, ODA generally played a greater role than trade preferences, reflecting the large ODA receipts per capita associated with their small populations, their proactive management of ODA flows, and the nature of their exports (which limited the effects of trade preferences).
- A survey of LDC officials carried out for this Report highlights both the insufficiency of existing ISMs and the importance of institutional constraints in LDCs as an obstacle to their effective use.

Notes

1 The Midterm Review of the IPoA was held on 27–29 May 2016 in Antalya, Turkey.

2 As mentioned in chapter 1, the concept of graduation from the LDC group was established only in 1991, 20 years after the establishment of the category itself.

3 Available at www.un.org/ldcportal.

4 A few of the ISMs listed in table 3.1 are also available to some non-LDC developing countries, notably preferential market access under the African Growth and Opportunity Act (AGOA) and the Generalized System of Preferences (GSP).

5 In 2012–2014 (the last three years for which data are available) net ODA received accounted for an average of 8 per cent of GNI in the median LDC, with considerable heterogeneity across individual countries. In Tuvalu, for example, it accounted for some 50 per cent of GNI, compared with less than 1 per cent in Angola and Equatorial Guinea.

6 The imputed share of multilateral aid is the portion of aid delivered by multilateral institutions which is estimated to have been funded by each donor country. The donor's total ODA is estimated by adding this to its bilateral aid (based on https://www.oecd.org/dac/stats/oecdmethodologyforcalculatingimputedmultilateraloda.htm, accessed October 2016).

7 Such an assessment would require computing the grant element for each individual loan, based on its interest rate, maturity and grace period, and aggregating the results for all loans to each recipient country in each year.

8 Climate change adaptation is understood by the Intergovernmental Panel on Climate Change (IPCC) as "Adjustment in natural or human systems in response to actual or expected climatic stimuli or their effects, which moderates harm or exploits beneficial opportunities", while mitigation is "An anthropogenic intervention to reduce the anthropogenic forcing of the climate system; it includes strategies to reduce greenhouse gas sources and emissions and enhancing greenhouse gas sinks" (Parry et al. 2007, Appendix I: Glossary).

9 A more detailed explanation of LDCF operations is provided in UNCTAD (2010:71–74).

10 At the time of writing, five LDCs were outside the WTO system, namely Eritrea, Kiribati, Somalia, Timor-Leste and Tuvalu.

11 For WTO members, preferential market access is legally covered by the "enabling clause" of the General Agreement on Tariffs and Trade (GATT).

12 No further progress on DFQF was reported during the Tenth WTO Ministerial Conference, and the Ministerial Declaration issued at the Conference (WTO, 2015a) does not mention the issue.

13 It should be noted that neither AGOA nor the GSP is LDC-specific, in that both also apply to some ODCs.

14 Some South-South regional trade agreements also contain SDT provisions for their LDC members. The South Asian Free Trade Area, for example has SDT provisions in favour of Afghanistan, Bangladesh, Bhutan and Nepal.

15 While major importing markets generally apply low tariffs to raw materials, it should be noted that tariff escalation continues to be a hindrance to vertical diversification and upgrading of LDC exports, including in the minerals sector (UNECA and AUC, 2013, chapter 3).

16 The potential coverage rate is the ratio between covered and dutiable imports. The utilization rate is the ratio between imports receiving preferential treatment and those potentially covered.

17 Eligibility for preferential treatment under AGOA is available to sub-Saharan African countries that comply with a series of criteria, including protection of private property, rule of law, elimination of barriers to United States investment, protection of intellectual property, implementation of social policies and human rights protection. The list of eligible countries is revised annually by the United States Government. As of October 2016, 27 of the 34 African LDCs were AGOA-eligible, the exceptions being the Central African Republic, the Democratic Republic of the Congo, Equatorial Guinea, Eritrea, Guinea-Bissau, Somalia and the Sudan (based on http://trade.gov/agoa/eligibility/index.asp, accessed October 2016).

18 Australia, Brazil, Canada, Chile, China, the European Union, Hong Kong (China), Iceland, India, Japan, Liechtenstein, Mexico, New Zealand, Norway, the Republic of Korea, Singapore, South Africa, Switzerland, Taiwan Province of China, Thailand, Turkey, the United States and Uruguay.

19 This does not include the SDT provisions envisaged in the Agreement on Trade Facilitation as it was not yet in force at the time of writing this Report. The discrepancy between the total number of SDT provisions (145) and the sum of the provisions of each type (157) arises because nine provisions are classified in more than one category.

20 SDT provisions in the Trade Facilitation Agreement are not included in the compilation by WTO (WTO, 2013c), which was the latest available at the time of writing.

21 Aid for Trade is generally divided into four broad areas: economic infrastructure, productive capacities, trade policy and regulations, and trade-related adjustments.

22 It is important to emphasize that data on aid for STI do not include ODA allocations to education, which can make an important long-term contribution to building absorptive capacity.

23 Aside from articles 7 and 66.2, the only explicit references to transfer or dissemination of technology in the Agreement are in article 8.2 (which recognises the need for appropriate measures, consistent with the Agreement, "to prevent … the resort to practices which … adversely affect the international transfer of technology"); and article 40.1 (which recognizes that "some licensing practices or conditions pertaining to intellectual property rights which restrain competition … may impede the transfer and dissemination of technology").

24 Data from the World Bank, World Development Indicators (accessed 15 September 2016).

25 The respondents were Burkina Faso, Burundi, Cambodia, the Central African Republic, the Gambia, Haiti, Nepal and the Niger.

26 This confirms the findings of CDP secretariat (2012).

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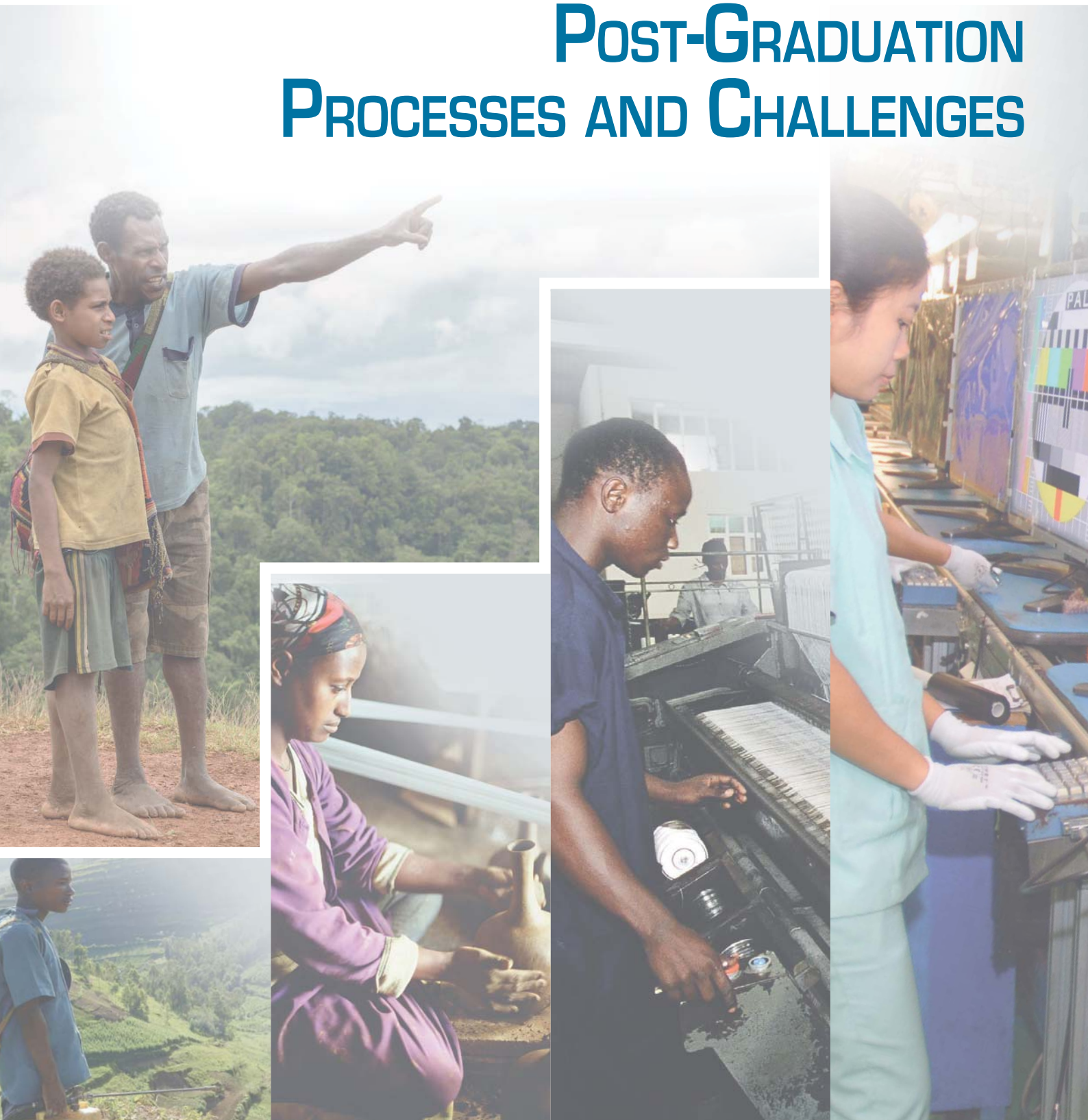
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CHAPTER 4

Post-Graduation Processes and Challenges



A. Introduction

Since the adoption of the 2011 Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the Istanbul Programme of Action (IPoA)), the feasibility of its graduation target has received considerable attention (Guillaumont and Drabo, 2013; Kawamura, 2014). Much less attention has been devoted to the question of least developed countries' (LDCs) development trajectory beyond graduation, apart from discussion among practitioners of the smooth transition process. This may reflect the focus of the international community on achieving the graduation target itself, or a perception that, once LDCs have graduated, they will be similar to other developing countries (ODCs), and thus face analogous development challenges.

The process of development beyond graduation merits attention as well as graduation itself.

This Report has argued that the process of development beyond graduation merits much greater attention, even during the pre-graduation period — that graduation itself should not be the primary focus of LDCs and their development partners, but should rather be viewed as one milestone in LDCs' longer-term sustainable development. Graduation does not represent a solution to all the graduating country's development challenges; neither does a new set of challenges emerge out of nothing at this point. Rather, the challenges of the post-graduation period are a continuation of those that characterized the pre-graduation period.

How LDCs achieve graduation matters for their post-graduation performance.

Equally, the development trajectory that leads a country to graduation has critically important implications for the challenges and vulnerabilities it will face after graduation, and the means at its disposal to address them. This highlights the importance of the path dependency of the development process — that is, the considerable role of the past processes that have led a country to its present situation in determining its future course. In planning a national graduation strategy, it is thus imperative to look ahead to the post-graduation period and anticipate the new and continued challenges this will present, while also taking account of the loss of access to LDC-specific support measures as a result of graduation itself.

This chapter is devoted to the post-graduation period, outlining the key implications of LDC graduation, and outlining the main development challenges LDCs may face in this period. Section B discusses the smooth transition process, providing some examples from the four countries that have already graduated. Section C focuses on the economic implications of LDC graduation, including an analysis of the potential costs of losing LDC-specific preferential access to Group of Twenty (G20) markets.[1] Section D examines some of the main development challenges that graduating countries are likely to face beyond graduation: the persistence of commodity dependence; the risk of reversion to LDC status; and the "middle-income trap".

The challenges and vulnerabilities a country will face after graduation depend on the process leading to graduation.

B. Smooth transition

The concept of smooth transition embodies the principle that LDC-specific support should be phased out in a gradual and predictable manner following graduation, so as not to disrupt the development progress of the graduating country, pursuant to General Assembly resolutions 59/209, 66/213 and 67/221, among others. The smooth transition period does not have a prescribed length, although the few systematic provisions that have been granted are of three years (CDP and UNDESA, 2015). However, monitoring of development progress by the Committee for Development Policy (CDP) is limited to a maximum of nine

years beyond graduation, as is the relevant intergovernmental process (figure 4.1). While smooth transition arrangements are of importance to all graduating countries, they are particularly critical in the case of island LDCs, due to their greater openness to international trade, reliance on external aid and exposure to exogenous shocks, as discussed in chapter 2 of this Report.

ISMs are phased out gradually after graduation under a "smooth transition" process.

Notwithstanding various General Assembly resolutions calling for effective smooth transition measures, the evidence is mixed. While many trading partners have adopted a policy of extending their LDC-specific trade preferences to graduating countries for a transition period, in line with General Assembly resolution 59/209, this is not universal.[2] Moreover, with the notable exception of access to the Enhanced Integrated Framework (EIF), there is a lack of formal procedures for smooth transition in relation to the special and differential treatment (SDT) provisions accorded to LDCs at the World Trade Organization (WTO). There is also little clarity regarding smooth transition procedures for other international support measures (ISMs), such as bilateral and multilateral official development assistance (ODA) allocations, aid modalities, and technical assistance.

There is a lack of formal procedures and clarity regarding smooth transition for most ISMs…

As well as arguably discouraging LDC governments from seeking graduation in the past, this lack of clarity has been an obstacle to graduating countries' preparation of smooth transition strategies during the three-year period preceding their effective graduation, as mandated by General Assembly resolution 59/209. In the absence of a systematic approach to smooth transition, the ability of a graduating country to retain access to ISMs for a transition period is heavily dependent on its ability to mobilize technical, financial and political support from its trade and development partners, bilaterally and multilaterally. As well as a thorough understanding of the availability and relevance of LDC-specific ISMs, this requires proactive engagement by the government with its partners and strong negotiating capacities (box 4.1).

…so that maintaining access to ISMs depends on the graduating country's negotiating capacities.

Overall, while the impacts of graduation should not be exaggerated, this assessment confirms that "further work needs to be done on smooth transition in order to provide assurances to LDCs that the international community will ensure that the continued development progress is a shared objective, and that assistance to the country will not be withdrawn in a manner inconsistent with that objective" (CDP, 2012:12). The importance of addressing this issue effectively is all the greater in the context of the IPoA graduation target, whose fulfilment would imply a much greater number of graduation cases than in the past.

Figure 4.1. Smooth transition procedures reporting by graduating and graduated countries and the CDP

<table>
<tr><th rowspan="2">Preparation of transition strategy, 3-year period</th><th rowspan="2">Graduation</th><th colspan="2">Implemention of transition strategy</th></tr>
<tr><th>3-years</th><th>Triennially</th></tr>
<tr><td>Transition period report procedures</td><td>3 years after General Assembly takes note of CDP recommendation</td><td colspan="2">Post-graduation report procedures</td></tr>
<tr><td>Graduating country
Invited to report annually to CDP on the preparation of the transition strategy</td><td rowspan="2">Graduation becomes effective</td><td>Graduated country
Reports annually to the CDP on the implementation of the smooth transition strategy for 3 years</td><td>Graduated country
Reports to the CDP as a complemenet to two triennial reviews on implementation of the smooth transition strategy</td></tr>
<tr><td>CDP
Monitors development progress in its annual reports to ECOSOC</td><td>CDP
Monitors development progress in consultation with graduated country for 3 years and reports results to ECOSOC</td><td>CDP
Monitors development progress in consultation with graduated country as a complement to two triennial reviews and reports results to ECOSOC</td></tr>
</table>

Source: CDP and UNDESA (2015).

Box 4.1. The smooth transition experience of recent LDC graduates

This box outlines the smooth transition and post-graduation experiences of the three recent LDC graduates, on the basis of country case studies conducted for this Report. Since specific procedures and principles to guide graduating LDCs through the transition from the category were introduced only in 2005 (with General Assembly resolution 59/2092), they were not applicable to the case of Botswana at the time of its graduation.

Cabo Verde

Cabo Verde is characterized by heavy dependence on external financing — notably ODA and remittances — and a high level of structural vulnerability. Consequently, concern about the effects of its graduation centred on the potential loss of ODA, which averaged 18 per cent of gross national income (GNI) in the 10 years before its graduation. While ODA has fallen since graduation, it has remained relatively high at 14 per cent of GNI (section E.3).

Cabo Verde's main trade partner is the European Union, from which the Government succeeded in obtaining a three-year extension of its eligibility under the Everything But Arms initiative (currently the standard practice for beneficiaries of the initiative), followed by an additional two-year transition period until 1 January 2012. In late 2013, Cabo Verde became one of the first 10 countries to qualify for the European Union's enhanced Generalized System of Preferences-plus (GSP+) trade regime, which is available to vulnerable countries that have ratified and implemented international conventions relating to human and labour rights, environment and "good governance".

In 2007, Cabo Verde signed a Special Partnership Agreement — a cooperation facilitation framework (unrelated to the Economic Partnership Agreement (EPA) under negotiation in the context of the Economic Community of West African States) covering a broad set of issues, from stability and regional integration to development and poverty reduction. It also concluded a Mobility Agreement with five European Union member States (France, Luxembourg, Netherlands, Portugal and Spain) allowing temporary and circular migration by Cabo Verdeans. Cabo Verde also approached multilateral agencies, including the World Bank and the African Development Bank, to ensure that it retained partial access to concessional financing (though at somewhat greater cost) through classification as a "blend" country. It also benefited from an additional three-year transitional period for access to the EIF, with a further two years subject to approval by the EIF Board.

While growth of the tourism sector provided a means of reducing Cabo Verde's dependence on aid and remittances, it was adversely affected by the global financial and economic crisis and by weak recoveries in key partner countries (notably in the European Union). Partly as a consequence, the country is now at a crossroads, facing challenges to the development of a more sustainable growth model and a more diversified productive base.

Maldives

Maldives has continued to experience relatively robust economic performance and significant progress in terms of human capital accumulation since its graduation from the LDC category in 2011. However, it remains heavily dependent on tourism and highly vulnerable to shocks, as indicated by the persistently high level of its economic vulnerability index (EVI).

Like Cabo Verde, Maldives benefited from a three-year extension of trade preferences under the Everything But Arms initiative, until the beginning of 2014. However, it ceased to be eligible for GSP preferences at the beginning of 2014 (as a result of its classification by the World Bank as an upper-middle-income country for three consecutive years), compounding the effect of its loss of preferential treatment. While the country's fishery industry survived the loss of trade preferences in the European Union market and Japan, this has certainly contributed to the sector's declining importance, notably in the case of the tuna industry.

The graduation of Maldives from the LDC category was instrumental in the negotiation of General Assembly resolution 65/286, which extended travel benefits (for example, to attend meetings of the United Nations and WTO) for a period of three years after graduation. The country also retained full access to EIF funds until 2013, and partial funding on a project-by-project basis for an additional two years, until the end of 2015.

While the success of Maldives' smooth transition strategy to date has been somewhat mixed, the latest (2015) CDP monitoring report found no sign of significant reversal in socioeconomic progress since the country's graduation in January 2011.

Samoa

Since Samoa graduated only in 2014, the conclusions that can be drawn about the transition process are limited. Like other Cabo Verde and Maldives, Samoa continues to enjoy duty-free quota-free (DFQF) treatment under the Everything But Arms initiative for a period of three years; and a similar transition period has been negotiated, at least for some key products, with other trading partners. China has agreed to extend zero tariff treatment on noni juice and other agro-processing products until 2017, while discussions are under way with Japan on a similar arrangement for noni juice, fish exports and organic products such as honey, vanilla and cocoa.

Samoa also continues to enjoy access to concessional borrowing from multilateral financial institutions, and to receive technical assistance and financial support to attend United Nations meetings. As in other cases, the country has also been granted a three-year transition period by the EIF.

In this context, the international community should consider, in particular:

- Promoting a deeper understanding of the technicalities of LDC graduation and its implications;
- Ensuring that countries continue to receive support appropriate to their respective development situations during the graduation process and in the post-graduation period;
- Defining a systematic and "user-friendly" set of smooth transition procedures applicable to all LDC graduates (notably in relation to international trade, where ISMs appear to be more significant);
- Providing enhanced technical assistance for the preparation of smooth transition strategies.

Further work is needed to ensure smooth transition and support commensurate with graduating countries' development needs.

C. Economic implications of graduation

Notwithstanding the smooth transition process, graduation from the LDC category ultimately entails the phasing out of the graduating country's access to LDC-specific ISMs; and this has potentially wide-ranging implications for the economy. Although the graduation process itself lasts at least six years, and smooth transition procedures may extend LDC treatment somewhat longer, these implications need to be taken into account in developing a national graduation strategy, to avoid sudden shocks to the economy. The main purpose of the monitoring process summarized in figure 4.1 is to ensure a thorough assessment of these graduation-related challenges in the specific context of each graduating country.

LDCs' graduation strategies need to take account of the phasing out of ISMs after graduation.

While this process is, by its nature, context-specific, the present section outlines some more general considerations and potential challenges relating to LDC graduation, from the perspective of "graduation with momentum". This discussion is divided into three subsections, examining respectively external financing, trade preferences, and SDT provisions in relation to WTO. The last of these subsections focuses on the extended implementation period for LDCs in the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement), reflecting the importance of technology in the post-graduation period.

The implications of graduation for access to external finance are potentially critical…

1. External financing

Since the great majority of LDCs run structural current account deficits and are heavily reliant on external finance to support their capital accumulation, the implications of graduation for external financing are potentially critical. Disruptions to access to such financing may result in balance-of-payments problems, which could jeopardize the continuation of the development process that led to graduation.

…but there is little reason to expect significant direct effects on private capital flows.

There is little reason to expect LDC graduation as such to have any direct effect on private capital flows such as foreign direct investment (FDI), remittances and portfolio investment. While a graduating country's ceasing to be an LDC might in principle lead to some improvement in investors' perceptions of its attractiveness as a destination for investment, the major determinants of FDI flows are unlikely to be directly affected by LDC status (as opposed to the development that underlies graduation).[3] Such determinants include, in particular, market size, resource and/or skill endowments, infrastructure, labour costs, tax and regulatory frameworks, and trade and investment agreements (Blonigen, 2005; Blonigen and Piger, 2014; Walsh and Yu, 2010; UNCTAD,

2012b, 2013). These factors appear to have a differential impact across sectors. As might be expected, natural resource endowments are the main driver of resource-seeking FDI flows, while competitive exchange rates and flexible labour markets appear to attract FDI in manufacturing, and FDI in the tertiary sector appears to be sensitive to independence of the judiciary and the quality of infrastructure (Walsh and Yu, 2010).

Similarly, good macroeconomic performance and a reliable financial sector tend to increase the likelihood that remittances are sent through official channels and are mobilized into diaspora investment (UNCTAD, 2012a); but there is little reason to expect LDC status to have any direct effect.

While graduation could have a greater effect on ODA, LDC status is rarely used to guide aid allocations.

In principle, graduation could have a more significant effect on access to ODA and other concessional financing, to the extent that donors use the LDC status of recipient countries explicitly as a criterion for aid allocations, as some studies have proposed (Guillaumont, 2008; Guillaumont et al., 2015). However, surveys conducted by the CDP suggest that donors rarely use LDC status to guide their ODA allocations, and that few bilateral donors have established LDC-specific programmes (CDP, 2012). Thus, despite the target of 0.15–0.20 per cent of donor countries' gross national income (GNI) for ODA to LDCs, there is little apparent evidence of an "LDC effect" on aid allocations.[4] Equally, it has long been recognized that aid allocations are affected, not only by recipient countries' needs, but also by donors' perceptions of their institutional quality, and by strategic and political considerations (Alesina and Dollar, 2000; Dollar and Levin, 2006). A recent analysis suggests that recipient countries' needs (represented by income per capita and the physical quality of life index[5]) are relatively weak determinants of ODA receipts, particularly in the case of bilateral aid (Mishra et al., 2012).

In the case of multilateral donors, eligibility for concessional financing windows is more important and it is not affected by graduation.

In the case of multilateral donors, a more important issue is that of eligibility criteria for concessional financing windows. As of 2016, all LDCs except Equatorial Guinea (classified by the World Bank as a high-income country) maintained at least partial access to concessional lending both from the World Bank (through the International Development Association (IDA)) and from their respective regional development banks (table 4.1). Four LDCs (Kiribati, Sao Tome and Principe, Tuvalu and Vanuatu) and all three recent graduates (Cabo Verde, Maldives and Samoa)[6] retain IDA eligibility under the "small-island exception",[7] and six LDCs through the World Bank's "blend" category (which combines IDA resources with non-concessional lending to provide a more limited degree of concessionality).

Eligibility for concessional financing affects the cost of financing rather than the amount.

However, eligibility for concessional financing windows is not generally linked to LDC status as such, but rather to GNI per capita — although the GNI-per-capita threshold used for this purpose by the World Bank and the regional development banks is very close to the LDC graduation threshold.[8] Thus the fact of graduation (as opposed to the increase in income that allows the income criterion to be met) does not have a direct effect on access to concessional finance. Even where access to concessional financing windows is reduced or lost as a result of increasing GNI per capita, access to non-concessional windows is generally maintained, so that the effect is on the cost of multilateral financing rather than its availability.

The development progress underlying graduation reduces the need for ODA.

At the same time, the development progress underlying graduation should, in principle, give rise to a progressive reduction in the need for ODA and other concessional financing during the course of the pre-graduation period. Similar considerations apply to the more specific case of Aid for Trade: LDCs tend to receive more Aid for Trade funding than ODCs relative to GDP, but not in absolute per-capita terms (De Melo and Wagner, 2016). Thus, there seems to be little reason to anticipate a sudden decline in Aid for Trade following graduation,

Table. 4.1. LDCs' and LDC graduates' access to concessional windows, selected multilateral development banks, 2016

	International Development Association (IDA)	African Development Fund (AfDF)	Asian Development Fund (AsDF)	Inter-American Development Bank
Afghanistan	IDA only		AsDF only	
Angola	IDA only			
Bangladesh	IDA only		Blend AsDF - ordinary capital resource	
Benin	IDA only	AfDF only		
Bhutan	Blend IDA-IBRD		AsDF only	
Burkina Faso	IDA only	AfDF only		
Burundi	IDA only	AfDF only		
Cambodia	IDA only		AsDF only	
Central African Republic	IDA only	AfDF only		
Chad	IDA only	AfDF only		
Comoros	IDA only	AfDF only		
Democratic Republic of the Congo	IDA only	AfDF only		
Djibouti	Blend IDA-IBRD	AfDF-Gap		
Equatorial Guinea				
Eritrea	IDA only (inactive)	AfDF only		
Ethiopia	IDA only	AfDF only		
Gambia	IDA only	AfDF only		
Guinea	IDA only	AfDF only		
Guinea-Bissau	IDA only	AfDF only		
Haiti	IDA only			Grant resources
Kiribati	Small-island exception		AsDF only	
Lao People's Democratic Republic	Blend IDA-IBRD		AsDF only	
Lesotho	Blend IDA-IBRD	AfDF-Gap		
Liberia	IDA only	AfDF only		
Madagascar	IDA only	AfDF only		
Malawi	IDA only	AfDF only		
Mali	IDA only	AfDF only		
Mauritania	IDA only	AfDF only		
Mozambique	IDA only	AfDF only		
Myanmar	IDA only		AsDF only	
Nepal	IDA only		AsDF only	
Niger	IDA only	AfDF only		
Rwanda	IDA only	AfDF only		
Sao Tome and Principe	Small-island exception	AfDF-Gap		
Senegal	IDA only	AfDF only		
Sierra Leone	IDA only	AfDF only		
Solomon Islands	IDA only		AsDF only	
Somalia	IDA only (inactive)	AfDF only		
South Sudan	IDA only	AfDF only		
Sudan	IDA only (inactive)	AfDF only		
Timor-Leste	Blend IDA-IBRD		Blend AsDF - ordinary capital resource	
Togo	IDA only	AfDF only		
Tuvalu	Small-island exception		AsDF only	
Uganda	IDA only	AfDF only		
United Republic of Tanzania	IDA only	AfDF only		
Vanuatu	Small-island exception		AsDF only	
Yemen	IDA only			
Zambia	Blend IDA-IBRD	Blend		
Botswana				
Cabo Verde	Blend IDA-IBRD and Small-island exception	Graduating to AfDB		
Maldives	Small-island exception		AsDF only	
Samoa	Small-island exception		AsDF only	

Source: UNCTAD secretariat compilation, based on http://ida.worldbank.org/about/borrowing-countries; http://www.afdb.org/en/about-us/corporate-information/african-development-fund-adf/adf-recipient-countries/; http://www.adb.org/site/adf/adf-partners, and http://www.iadb.org/en/about-us/idb-financing/fund-for-special-operations-fso,6063.html (accessed July 2016).

especially as the main LDC-specific programme (the EIF) has well-established smooth transition procedures.

Graduation has a more direct impact on financing for climate change adaptation.

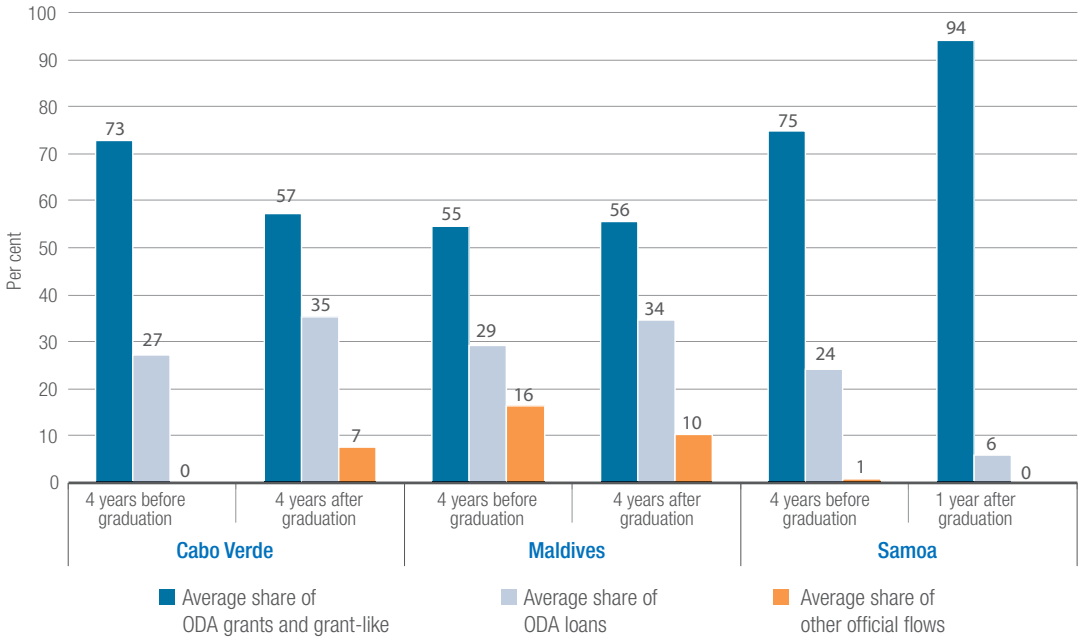
This assessment is broadly supported by the experiences of the three most recent LDC graduates (Cabo Verde, Maldives and Samoa) as shown in figure 4.2.[9] In both Cabo Verde and Maldives, a greater share of total official flows took the form of loans following LDC graduation, indicating some reduction in the degree of concessionality. (While this was not apparent for Samoa, data are available for only one year after graduation.) It is possible, however, that this pattern partly reflects country-specific issues, such as dependence on a small number of donors and/or limited capacity to negotiate favourable smooth transition terms, as well as the impact of the global financial and economic crisis on bilateral ODA budgets. The progressive reduction of the share of grants in official flows following LDC graduation is also consistent with bilateral donors' responses to the survey conducted by the CDP secretariat (CDP, 2012).

Overall, graduation is unlikely to trigger abrupt changes in access to development finance or private flows.

Graduation has a more direct impact on financing for climate change adaptation, as graduating countries lose access to LDC-specific funding sources, most notably the LDC Fund. While they retain access to other sources of climate financing, such as the Green Climate Fund, their access to such sources depends on their ability to compete effectively with ODCs – a competition in which they would continue to be hampered even after graduation by their relatively limited institutional and human capacities (UNCTAD, 2009). In principle, 50 per cent of Green Climate Fund financing is to be allocated to particularly vulnerable countries, including small island developing States (SIDS) and African States as well as LDCs. However, graduating Asian LDCs would not benefit from this target, while graduating African countries and SIDS would need to compete with better-resourced ODCs within these categories.

Overall, while graduation may entail some costs in terms of reduced concessionality of official flows and reduced access to climate financing, it is

Figure 4.2. Composition of total official flows before and after LDC graduation



Source: UNCTAD secretariat calculations, based on data from the OECD, Creditor Reporting System database (https://stats.oecd.org/Index.aspx?DataSetCode=CRS1) (accessed June 2016).

Notes: The periods used to compute the four-year averages are as follows (pre-graduation and post-graduation, respectively): Cabo Verde 2004–2007 and 2008–2011; Maldives 2007–2010 and 2011–2014; and Samoa 2010–2013 and 2014. In the case of Samoa, only one year after graduation is considered because no data are available after 2014. No pre-graduation data are avfailable for Botswana.

unlikely to result in abrupt changes in countries' access to other development finance or to private flows such as FDI. The experiences of the LDC graduates to date also suggest that governments can attenuate graduation costs related to ODA flows significantly by engaging proactively with key development partners at an early stage to negotiate ad-hoc transitional arrangements.

2. Trade preferences

LDC graduation entails the loss of preferential market access under LDC-specific schemes.

The most visible trade-related implication of LDC graduation is the loss of preferential market access under LDC-specific schemes such as the European Union's Everything But Arms initiative and of the concessions granted to the LDCs under the Global System of Trade Preferences among developing countries (GSTP).

The impact on a graduating country's exports of losing preferential market access is determined by three main factors:

(a) The coverage and structure of preferential schemes for which the LDC is currently eligible, but will cease to be eligible (possibly after transition period) as a result of graduation;

(b) The product composition of exports, and their distribution across markets;

(c) The fallback tariffs to which the country's exports will be subject after graduation.

The impact of graduation depends on the interplay between the features of each scheme and each LDC's export patterns…

With respect to the first element, a growing number of developed countries and ODCs have adopted some form of preferential schemes for LDCs over time, making significant progress towards the goal (enshrined in both the Sustainable Development Goals and the WTO Doha Agenda) of providing duty-free quota-free (DFQF) market access to LDCs' exports.[10] However, these schemes differ significantly in terms of product coverage, exclusion lists (that is, tariff lines for which no liberalization is granted) and preference margins (Laird, 2012) (table 4.2). Their overall impact thus depends on the interplay between the specific features of the various schemes, and the composition and geographical distribution of LDCs' exports. It is well-established that the effectiveness of preferential schemes is weakened by their incomplete coverage, particularly given the heavy concentration of LDC exports in a very narrow range of products. Moreover, the remaining tariffs and tariff peaks often affect sectors that are commercially relevant for LDCs, notably agricultural products, textiles and apparel (Borchert et al., 2011; Laird, 2012). Utilization of preferential schemes, and hence their effectiveness, also appears to be affected positively by the size of preference margins, and negatively by the costs of compliance with the associated rules of origin (International Trade Centre, 2010; Keck and Lendle, 2012; Hakobyan, 2015).

…and the tariffs applicable to its exports after graduation, which may be affected by other trade agreements.

While graduation ultimately results in ineligibility for such LDC-specific preference schemes, this does not necessarily mean that the graduate's exports will be subject to most-favoured nation (MFN) treatment, as graduating countries may continue to benefit from bilateral, regional or other (non-LDC-specific) preferential arrangements with trade partners. In these circumstances, LDC graduates may retain a significant margin over the MFN rate, at least limiting the degree of preference loss. For example, on graduation, an LDC participating in the GSTP agreement would lose the benefits of the special concessions accorded to LDCs by other GSTP members; but it would retain the broader preferential treatment stemming from GSTP membership.

Similarly, in cases where the LDC preferential scheme is part of the broader GSP, an LDC graduate would cease to benefit from some special concessions, but would in principle retain some degree of preferential access as an ODC.[11] In some cases, graduating countries may even escape preference losses in some markets entirely, for example through unilateral preference schemes such as the

Table 4.2. Overview of selected preferential market access schemes in favour of LDCs

Preference-granting country/ economy	Number of dutiable tariff lines (national tariff lines)*	Duty-free coverage (major exclusions)	References on notifications
Australia	0	100%	WT/COMTD/N/18
Canada	105	98.6% (dairy, eggs and poultry)	WT/COMTD/N/15/Add.1, WT/COMTD/N/15/Add.2 and WT/COMTD/N/15/ Add.3
China	..	97%	WT/COMTD/N/39 and WT/ COMTD/N/39/Add.1/Rev.1 WT/COMTD/LDC/M/76
European Union	91	99.0% (arms and ammunitions)	WT/COMTD/N/4/Add.2, WT/COMTD/N/4/Add.4, WT/COMTD/N/4/Add.5 and WT/COMTD/N/4/Add.6
India	674	94.1% (meat and dairy products, vegetables, coffee, tobacco, iron and steel products, copper products, etc.)	WT/COMTD/N/38
Japan	197	97.9% (rice, sugar, fishery products, articles of leather)	WT/COMTD/N/2/Add.14 and WT/COMTD/N/2/ Add.15
Republic of Korea	1 180	90.4% (meat, fish, vegetables, food products, etc.)	WT/COMTD/N/12/Rev.1 and WT/COMTD/N/12/ Rev.1/Add.1
Russian Federation (2012)	6 885	38.1% (exclusions cover a wide range of tariff lines including petroleum products, copper, iron ores, articles of leather, articles of apparel and clothing, etc.)	WT/COMTD/N/42
Turkey (2011)	2 384	79.7% (meat, fish, food, steel products, etc.)	-
United States**	1 864	82.6% (dairy products, sugar, cocoa, articles of leather, cotton, articles of apparel and clothing, other textiles and textile articles, footwear, watches, etc.)	WT/COMTD/N/1/Add.7 and WT/COMTD/N/1/Add.8

Source: UNCTAD secretariat compilation, based on Laird (2012) and WTO (2014).

Notes: The table only reports preferential trade arrangements by G20 member countries; in addition, as of June 2016 the following countries/ territories have notified to the WTO some preferential market access schemes in favour of the LDCs: Chile, Iceland, Kazakhstan, Kyrgyzstan, Morocco, New Zealand, Norway, Switzerland, Taiwan Province of China, Tajikistan, and Thailand.

* Tariff lines may vary from year to year due to change in national tariff nomenclature.

** In addition to the GSP, the United States provides two other major preferential schemes of relevance for LDCs, namely the Caribbean Basin Trade Partnership Act (CBTPA) - which grants duty-free access for most products originating from Haiti and other Caribbean countries - and the African Growth and Opportunity Act (AGOA) granting further tariff reductions (compared to the GSP) to 37 qualifying African countries, 24 of which LDCs.

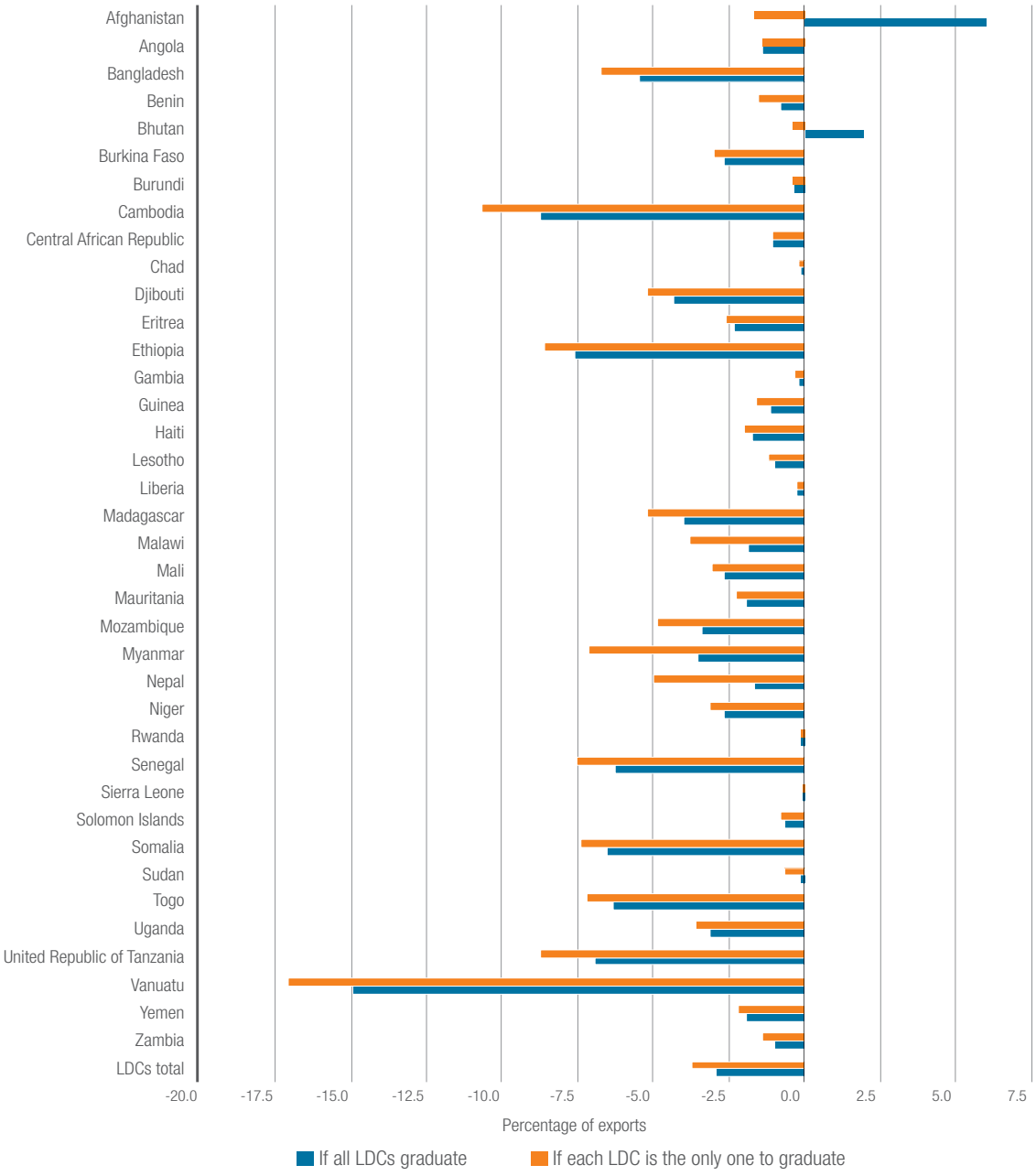
United States' African Growth and Opportunity Act (AGOA) or membership of a bilateral or regional trade agreement whose provisions are not dependent on LDC status.[12]

Since all the above factors are context-specific and depend on the particular trade pattern and trade agreements of each country, their potential impacts should be carefully assessed in preparation for graduation, taking into account the future trade context. The ex-ante impact assessment and vulnerability profile produced at the time of graduation are intended in part to provide the basis for such an assessment.

The potential impact of losing LDC-specific trade preferences is estimated at $4.2 billion annually for LDCs as a whole.

While such an exercise is beyond the scope of this Report, this section seeks to estimate the order of magnitude of potential preference losses in G20 markets related to LDC graduation, based on the methodology presented in annex 1. Figure 4.3 shows the results of this analysis for the 38 LDCs for which data are available, based on simulations of two hypothetical scenarios, representing the upper and lower bounds of the potential impacts. In the first, a single LDC graduates, so that only its own tariffs are affected. Consequently, the changes in the tariffs it faces are translated directly into an equivalent change in its preference margins. In the second, all LDCs graduate, and the effects on each are estimated. In this case, the direct effect on preference margins of the

Figure 4.3. Effects of preference losses related to LDC graduation vis-à-vis G20 countries



Source: UNCTAD secretariat calculations.

reduction in tariffs faced by each country is at least partly offset by the reduction in tariffs faced by others, so that the effect on preference margins is ambiguous.

This analysis indicates a potential effect on LDCs of losing LDC-specific preferential treatment in the G20 countries equivalent to a reduction of 3–4 per cent of their merchandise export revenues. If extrapolated to all 48 LDCs, this would amount to more than $4.2 billion per year (table 4.3). It should be noted, however, that these effects may be diminished over time to the extent that tariffs on imports from ODCs are reduced (for example, under mega-regional trade agreements). This would have the effect of reducing LDCs' preference margins in the markets concerned, and thus the costs of losing preferential market access on graduation.

The greatest trade effects are on agricultural commodities, textiles and apparel.

The greatest adverse effects would be on exports for which tariffs are generally highest for non-LDCs, namely agricultural commodities, textiles and

Table 4.3. Annual effects of preference losses extrapolated to all LDCs, by region

	Exports to G20 countries ($ millions)	Percentage effect (weighted average of LDCs in the region)	Overall effect of losing LDC preferential market access ($ millions)
Total LDCs	145 497	-2.9	-4 270
African LDCs	104 572	-1.7	-1 817
Asian LDCs	40 475	-5.2	-2 093
Island LDCs	450	-2.4	-11

Source: UNCTAD secretariat calculations.
Notes: Exports of all LDCs (including those without detailed tariff data) to the G20 countries mentioned in annex 1 of the main text. Since the table refers to LDCs by region, effects are computed in the hypothetical scenario where all LDCs have graduated, and should be regarded as a "lower bound" of potential export losses related to the phasing out of LDC-specific preferential schemes.

African LDCs will be typically less adversely affected than Asian LDCs.

apparel (figure 4.4). At the other end of the scale, low tariffs on energy, mining and wood products (regardless of LDC status), mean that exports in these categories would not be greatly affected by loss of preferential market access.

Consequently, the potential impact of loss of preferential market access differs widely between LDCs and across regions, primarily reflecting differences in their export patterns and fallback tariffs. African LDCs are typically less adversely affected than Asian LDCs for two main reasons.

- First, African LDCs' exports are more dominated by primary commodities, whose tariffs tend to be lower regardless of LDC status (with the exception of agricultural commodities and animal products).
- Second, while existing regional trade agreements — the Association of Southeast Asian Nations (ASEAN)–China and ASEAN–India agreements — would allow Asian LDCs to retain significant preference margins in regional markets after graduation, they would experience a significant worsening of their access to key developed country markets. Many African LDCs, conversely, would retain significant preference margins in major Western markets even after graduation, owing particularly to AGOA and the EPA initiative.[13] It should be noted, however, that reciprocal trade agreements have implications on the import side as well as the export side, and that EPAs require a progressive opening of some 80 per cent of the domestic markets of signatory countries to European Union exports.

The cost of graduation depends in part upon which other LDCs have already graduated…

For Asian LDCs, the greatest adverse effects would be on textile and apparel exports. In the case of African LDCs, the main impact would be on exports of agricultural commodities other than wood and animal products, and to a lesser extent on non-agricultural exports other than energy and mining products, textiles and apparel. In a few cases, such as Mali and Vanuatu, exports of animal products or fish would also be substantially affected, mainly because of high fallback tariffs in key export markets.

…because the value of preferential market access increases as other LDCs lose such access on graduation.

It may be observed in figure 4.3 that two countries — Afghanistan and Bhutan — show the apparently perverse result of a positive impact of losing preferences in the scenario of all LDCs graduating. This highlights an important point: that the cost of graduation depends in part upon which other LDCs have already graduated.

As noted above, in the scenario of all countries graduating, each LDC's loss of preferences is partly offset by the effects of competing LDCs also losing preferences, which limits the impact on preference margins. Afghanistan and Bhutan represent outliers in this respect, in that the cost of their own loss of LDC-specific market access is more than offset by the gains resulting from other LDCs losing such access. This arises largely because both countries have preferential bilateral trade agreements with India, so that the effect of graduation

on access to the Indian market will at most be very limited. Conversely, other LDCs will face much greater tariff increases on graduation, so that the preference margins of Afghanistan and Bhutan in the Indian market will be increased significantly. This has a considerable impact, as both Afghanistan and Bhutan are landlocked countries neighbouring India, which is consequently their major export destination.

Additional indirect costs may arise from the loss of opportunities for export diversification or entry into new markets…

Though an extreme case, this illustrates a more general issue — while each country loses from its own loss of preference at graduation, it gains (generally only slightly) from an increase in its preference margins when other LDCs graduate. Equally, as other LDCs graduate, the value of preferential market access is increased, as the group of countries receiving market preferences becomes progressively smaller, increasing overall preference margins. Thus, the cost of graduation becomes somewhat greater over time as other LDCs graduate.

It should also be noted that the analysis presented above takes account only of the direct effects on trade of loss of preferences, based on the current geographical distribution and product composition of exports. Additional dynamic costs may arise to the extent that the reduction in competitiveness associated with loss of preferential access limits opportunities for export diversification through sales of new products and/or entry into new markets.

…or reduced attractiveness to foreign investors seeking market access.

Beyond its direct trade benefits, preferential access to major export markets can play a significant role in attracting FDI, notably in the context of buyer-driven global value chains (UNCTAD and UNIDO, 2011; UNCTAD, 2013). For example, the locational decisions of investors from Taiwan Province of China who have established clothing factories in Lesotho and Madagascar have been motivated not only by relatively low labour costs, but also, more importantly, by the opportunity to exploit preferential access to the United States market under AGOA (Staritz and Morris, 2013; Morris and Staritz, 2014). Where LDC-specific market preferences play a similar role, loss of preferential market access following graduation (and any related uncertainty with respect to smooth transition provisions) could affect a country's attractiveness for FDI in certain sectors.

Graduating countries can reduce graduation costs if they negotiate market preferences with their trading partners.

There are two possible means of avoiding or limiting the impact of loss of preferential market access, although neither is costless or necessarily reliable. First, a graduating country may be able to maintain preference margins following graduation, at least in part, through bilateral negotiations with its trade partners. However, this would require a proactive effort, matched by the required negotiating capacities, and (as in any negotiation) success might well require concessions to be made in other areas. Much also depends on the goodwill of trade partners. Bilateral negotiations over preferential treatment may also be influenced by other factors, such as geographical proximity, geopolitical considerations, and natural resource endowments considered to be of strategic importance. Such considerations create a playing field that is by no means level, and by no means always advantages those in greatest need.

It may be possible to maintain preference margins after graduation.

Second, policy measures can be implemented to counter the reduction in competitiveness arising from loss of preferential market access. However, this may entail substantial costs, for example for additional investments in infrastructure. Such measures are also needed, over time, as a result of preference erosion. This is a subject of concern for Bangladesh, for example, whose successful development of manufacturing and export integration into the world economy has depended significantly on its preferential market access as an LDC, under WTO, GSP schemes with bilateral partners such as the European Union and Canada, and regional trade agreements such as the South Asian Free Trade Area and the Asia–Pacific Trade Agreement (Rahman, 2014).

Preference loss can be compensated by measures to increase competitiveness.

Figure 4.4. Effects of preference losses related to LDC graduation by sector

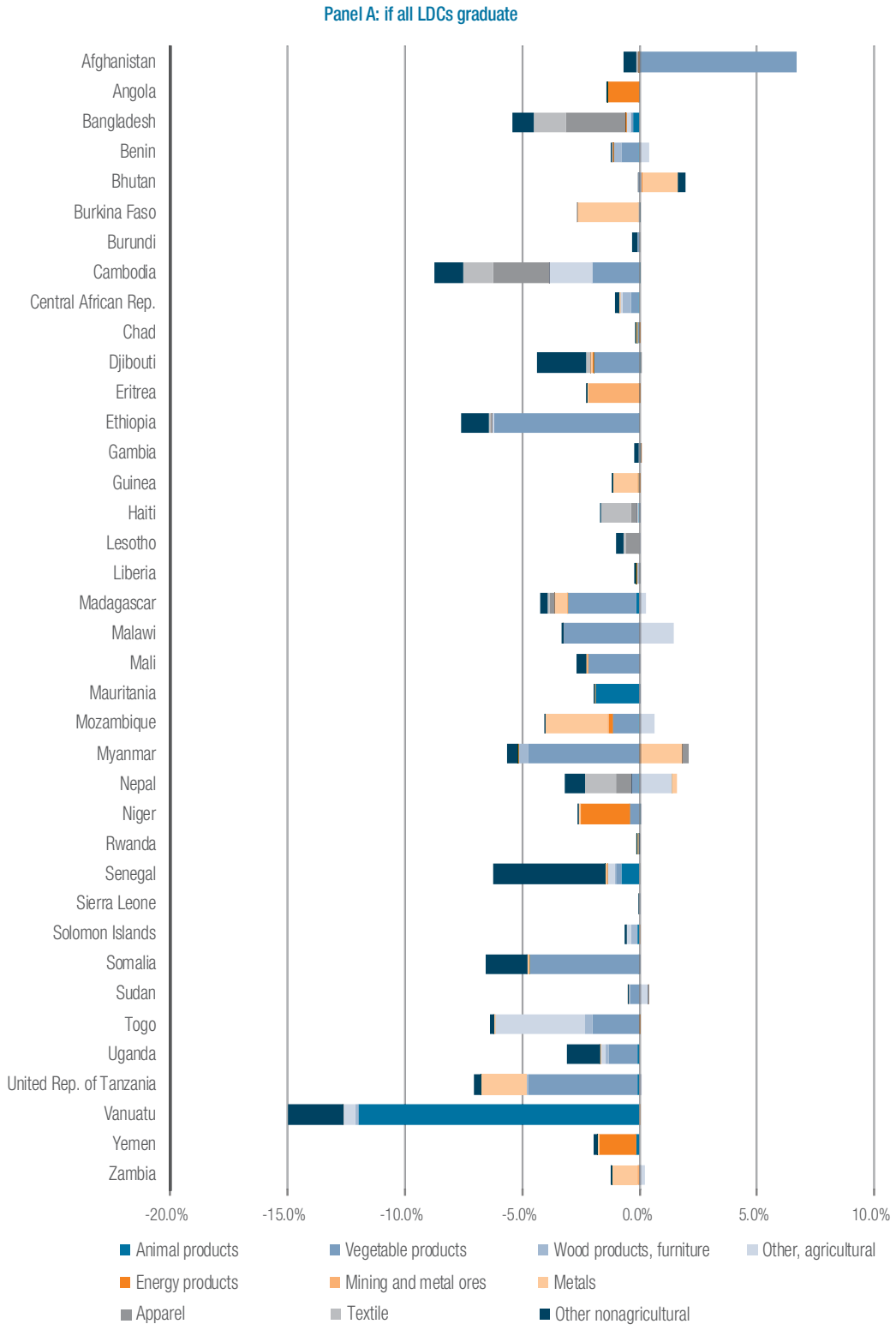
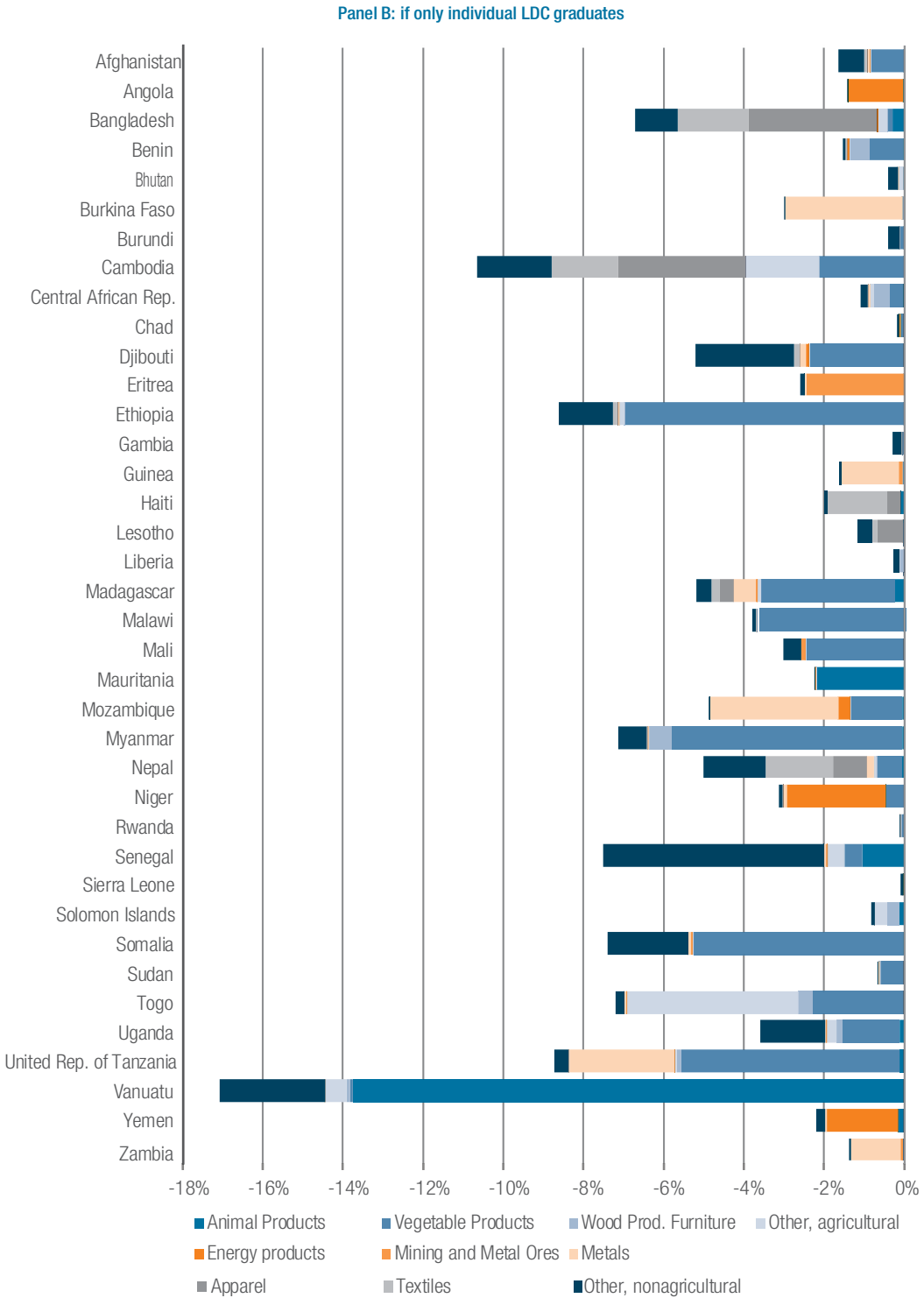


Figure 4.4 (contd.)



Source: UNCTAD secretariat calculations.
Note: The following LDCs are not included in this figure due to lack of data: the Comoros, the Democratic Republic of the Congo, Equatorial Guinea, Guinea-Bissau, Kiribati, the Lao People's Democratic Republic, Sao Tome and Principe, South Sudan, Timor-Leste and Tuvalu.

3. Special and differential treatment

By the end of the smooth transition period, graduating countries have lost access to all LDC-specific SDT provisions under WTO rules and WTO-compliant regional trade agreements, as well as those afforded by their trading partners, retaining access only to the typically less generous provisions available to ODCs.

Loss of access to SDT provisions can limit policy space and flexibility and give rise to adjustment costs…

As discussed in chapter 3, the substantive content of many such provisions is relatively limited (as, for example, in the cases of the General Agreement on Trade in Services and the Agreement on Trade-related Investment Measures); and LDCs' ability to make full and optimal use of them is constrained by their institutional and productive capacities (UNCTAD, 2006, 2009). Nonetheless, this loss of entitlement can limit policy space and flexibility in designing and implementing economic policies and strategies for economic diversification and development of productive capacities in the post-graduation period. There are also some other adjustment costs, for example arising from the need for bilateral negotiations with trading partners on new trade and investment arrangements and for more rapid implementation of WTO rules as a result of shorter transition periods.

…most notably in the case of the TRIPS Agreement…

The TRIPS Agreement is possibly the most significant case of potential graduation costs arising from loss of eligibility for SDT provisions (although the benefits of such provisions may be limited in WTO member countries that have bilateral or regional trade or investment agreements that include TRIPS-like or "TRIPS-plus" provisions on intellectual property rights). The extended implementation periods to which LDCs are entitled under the TRIPS Agreement (as discussed in chapter 3) provide potentially important policy space for the development of technology-related sectors. The still longer implementation period for the pharmaceuticals sector has provided the policy space and the legal certainty needed to foster the development of a pharmaceutical industry in Bangladesh, for example.

…but such costs may be more limited for countries which have achieved graduation with momentum.

The loss of eligibility for the extended implementation period for LDCs under the TRIPS Agreement also gives rise to substantial additional financial costs and administrative burdens for graduating countries, to establish domestic legal and institutional intellectual property frameworks consistent with the TRIPS Agreement requirements for non-LDCs, as well as potentially higher prices for technology-intensive products. In principle, the SDT provisions under the TRIPS Agreement also provide a basis for LDCs to request specific technical assistance for technology transfer and the adaptation of foreign technologies to local conditions, although the extent of such assistance provided under such provisions appears to have been limited to date.

Despite the limitations of SDT provisions for LDCs and the constraints to their utilization, their loss as a result of graduation can give rise to some additional costs beyond those arising from loss of preferential market access. However, such costs may be more limited for those countries that have attained a certain level of productive capacities and economic diversification and have thus established a self-sustaining sustainable development trajectory – that is, those that have achieved graduation with momentum. Thus, the nature of graduation itself is a significant factor in determining the SDT-related costs of graduation.

Overall, the costs of losing access to LDC-specific ISMs are likely to be limited.

4. Conclusion

Overall, the above assessment suggests that any losses arising from the phasing out of LDC-specific support are in most cases likely to be relatively limited. Graduating countries can generally fall back on non-LDC-specific support measures (such as different financing windows, other types of

preferential treatment, and SDT provisions for ODCs), which, though less generous than those available to them before graduation, still provide a certain degree of support. This is the counterpart of the shortcomings of LDC-specific ISMs discussed in chapter 3 — that the loss of eligibility for them can be expected to have a commensurately limited impact, and certainly should not be insurmountable. This is confirmed by the experiences of past graduates.

There is a need to systematize smooth transition procedures.

This by no means negates the need for a smooth transition. On the contrary, strong leadership and sound preparation of the transition towards the post-graduation phase is essential, to anticipate the needs and challenges arising from graduation, to devise appropriate strategies, and to limit the adjustment costs. This includes early efforts to map and address the changes needed to institutional and legal frameworks to comply with newly applicable disciplines, notably in the context of WTO agreements. The expected increase in the number of LDC graduates in the coming years highlights the need for the international community to systematize smooth transition procedures, to increase understanding of them, and to enhance their overall effectiveness, so as to ensure that future graduates continue to receive support commensurate with their development needs.

D. Post-graduation challenges

The challenges of the post-graduation period represent an evolution of those experienced prior to graduation.

As highlighted in chapter 1 of this Report, graduation should be regarded as a milestone in a country's long-term development trajectory, and not as a goal in itself. Development challenges neither disappear nor begin anew upon graduation. Rather, the challenges of the post-graduation period represent an evolution of those experienced prior to graduation; and this evolution is itself, in part, a product of the development process that leads to graduation. Equally, while graduation in principle indicates greater resilience and/or reduced exposure to structural vulnerabilities, many LDCs (notably SIDS) can be expected to remain particularly prone to exogenous shocks even after graduation. It is noteworthy in this context that no LDC graduate has yet reached the graduation threshold for the EVI. Moreover, loss of eligibility for SDT provisions may result in a narrowing of the policy space available to address these challenges.

Such challenges include persistent commodity dependence, the risk of reversion to LDC status and the middle-income trap.

This indicates a substantial degree of path dependency, in that a graduating country's economic prospects after graduation are significantly affected by the economic and social development trajectory that leads it to graduation, as well as its use of the smooth transition process and the broader international environment following its graduation. In this respect, many LDCs are likely to face one or more of three major challenges beyond graduation: persistence of commodity dependence; a risk of reversion to LDC status; and the middle-income trap. These challenges are discussed in turn below.

1. Persistent commodity dependence

Many graduates will remain heavily dependent on commodities.

Despite low international commodity prices, recent trends suggest that commodity dependence will remain a major feature of several LDC graduates (notably Angola, Equatorial Guinea and Timor-Leste), as it is of many ODCs, particularly in the lower-middle-income range (UNCTAD, 2015a). As discussed in chapter 2 of this Report, commodity exports are expected to play a major role in generating export revenues in most of the pre-2025 graduates, with the exception of manufactures exporters (Bangladesh, Bhutan and Lesotho) and service exporters (Nepal, Sao Tome and Principe, and Vanuatu). Unless graduating countries in the other (fuel, mineral and agricultural) export categories

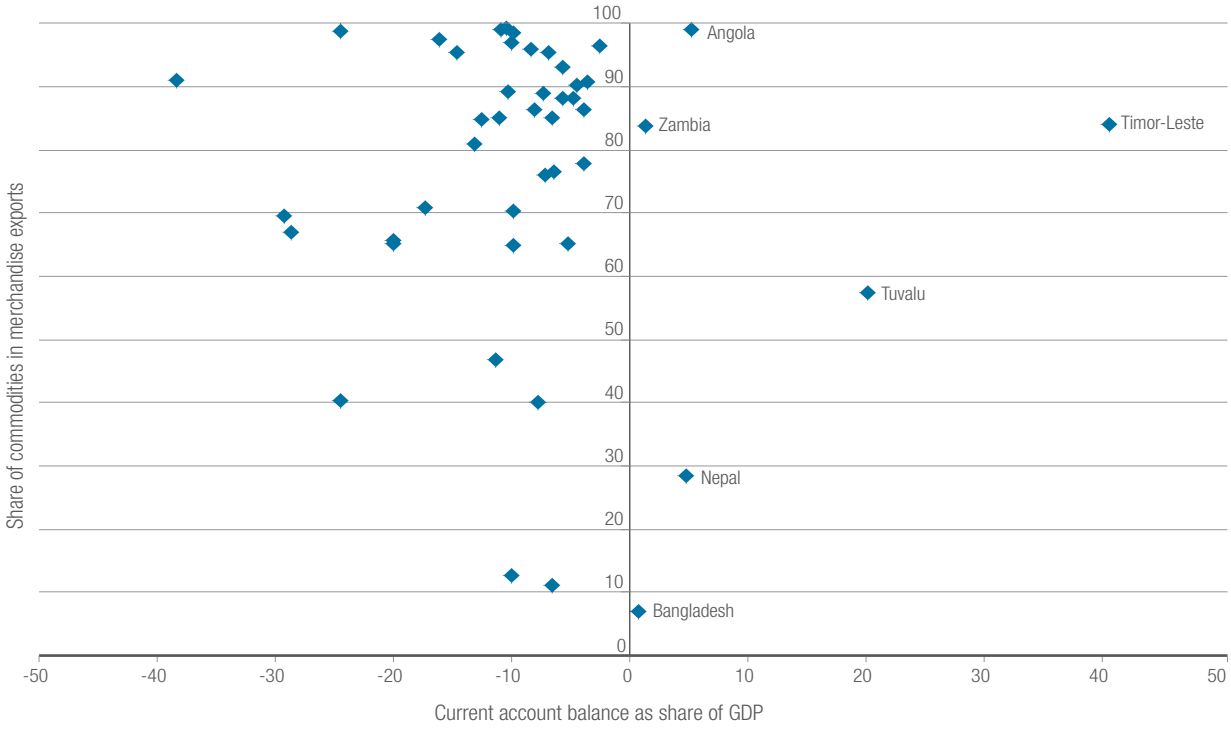
can find some means of escaping commodity dependence, they can be expected, in varying degrees, to face similar problems after graduation to those they have confronted as LDCs.[14]

In the overwhelming majority of LDCs, primary commodities account for a considerable proportion of export revenues and play a key role as a source of employment and livelihoods (in the case of agricultural commodities) or public revenues (in the case of fuels and minerals). This is unlikely to change abruptly on graduation.[15] While numerous African LDCs, in particular, depend heavily on fuels and minerals for export revenues, LDCs' commodity-dependence is exemplified across LDCs more generally by the role of the agricultural sector. While this employs some two thirds of the LDC labour force, it is characterized by slow labour productivity growth, chronic underinvestment, limited transformation of raw materials and intermediate inputs, and widespread poverty among smallholder farmers and landless labourers (UNCTAD, 2015b).

In LDCs, commodity dependence is compounded by high import propensities and chronic current account deficits.

While commodity dependence is in itself an important source of economic vulnerability, in the case of LDCs it is typically exacerbated by two additional factors: a high import propensity (notably of fuels), which plays an essential role in ensuring the full utilization of productive capacities (UNCTAD, 2004); and chronic current account deficits (figure 4.5).[16] Not only do LDCs rely on foreign savings to sustain their capital accumulation, but this reliance is frequently reinforced by major adverse terms-of-trade shocks. While such shocks may be mitigated to some extent by official finance, this exposes LDCs to risks of real exchange rate depreciation, import compression, reductions in much-needed investment and slowdowns of economic activity (Cavallo et al., 2016).

Figure 4.5. Commodity dependence and current account balance, 2012–2014



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database (accessed July 2016).

2. The risk of reversion

The LDC classification system has four features designed to limit the risk of graduating countries falling back into the LDC category. First, the thresholds for graduation are set at levels significantly more demanding than those for inclusion in the group, to reduce the risk that economic setbacks after graduation will result in the country again becoming eligible for LDC status. Second, unlike the inclusion criteria, graduation criteria must be met in two consecutive triennial reviews, to ensure that statistical eligibility for graduation is not a result of temporary changes in indicators; and the transition process is designed to ensure that graduation actually reflects long-term structural progress (section B). Third, several of the indicators used are averaged over time, so as to reduce the impact of short-term fluctuations. Fourth, rather than recommending graduation automatically on the basis of the graduation criteria alone, the CDP also takes account of broader considerations not captured by the criteria. On several occasions, consideration of qualitative factors has led to graduation being delayed (chapter 1).

The LDC classification system is designed to limit the risk of graduating countries reverting to LDC status…

Despite these in-built precautions, reversion of graduates to the LDC category is not impossible. A country could, in principle, graduate by narrowly meeting the graduation threshold(s), without having acquired sufficient resilience or having built a sufficiently solid and diversified productive base to sustain its development progress.

…but such reversion is not impossible.

This is by no means only a theoretical possibility. Some ODCs that have never previously been classified as LDCs have met the thresholds for inclusion in the LDC category, but have not entered the group because their governments have declined to accept LDC status (CDP and UNDESA, 2015). While any country can encounter growth setbacks, this is a greater risk for LDCs due to their particular vulnerability, whose structural causes do not necessarily end with graduation.

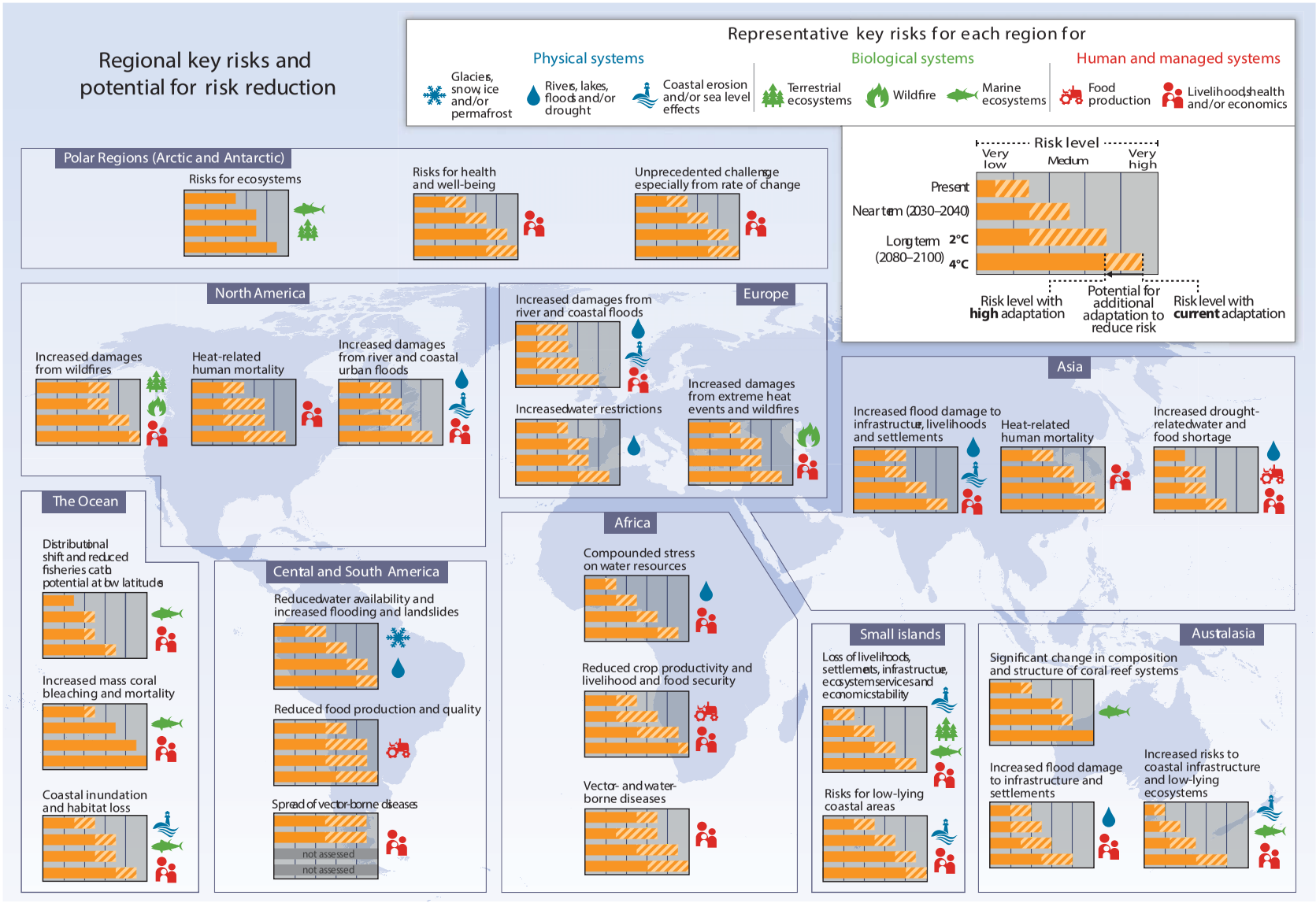
For some LDCs, environmental vulnerability is particularly important…

For some LDCs, environmental risks are of particular importance (figure 4.6). Most LDCs are characterized by a high level of vulnerability to environmental threats, as a result of their particular exposure to the multidimensional impacts of climate change; their less resilient infrastructure; and their heavy reliance on natural resources, and particularly on rain-fed agriculture. As the effects of climate change are expected to intensify in the coming years, these factors pose considerable and multifaceted challenges to LDCs, reinforcing the already considerable pressure on their natural resources (IPCC, 2015). This may negatively affect the prospects of LDCs and LDC graduates alike, in some cases potentially increasing the risk of a standstill or reversal of the development process.

…and the risk of reversion may be increased by a more challenging global economic environment.

The risk of reversion may be increased for countries that graduate in the near future to the extent that the international context for development becomes more challenging in the short and medium term. The sluggish growth rate of the world economy and global trade has led to concerns about “secular stagnation”, which translates directly into weak demand for exports from LDCs and graduates by limiting the ability of large economies to absorb additional imports. This may be expected to dampen the effect of foreign demand on LDCs’ growth and structural transformation (Teulings and Baldwin, 2014; UNCTAD, 2016b).

Figure 4.6. Climate-related risks and potential for risk reduction



Risk levels are not necessarily comparable across regions.

Source: IPCC (2015).

3. The middle-income trap

Like ODCs, graduating LDCs may face challenges in sustaining economic growth sufficiently to progress from low to middle income and from middle to high income, rather than being caught in the middle-income trap.[17] While this issue is often regarded as lying well beyond LDCs' graduation horizon, 18 of the 48 LDCs are currently classified by the World Bank as middle-income countries, and one as a high-income country.[18] Equally, all LDC graduates remain in the middle-income group, suggesting that the persistence of structural vulnerabilities, from infrastructure gaps to low levels of human capital, may limit their ability to progress to the high-income category.

Graduating LDCs may later be caught in a "middle-income trap".

The challenges of economic convergence are demonstrated by the relatively low (and arguably declining) probability of moving from low- and middle-income groups to high-income level, and the increasing probability of falling back into a lower category (UNCTAD, 2016b). While there is no consensus on a rigorous definition of the middle-income trap (box 4.2), or even on its existence, the concept can provide insights into the policy challenges that productivity slowdowns and other key transitions present for structural transformation and graduation with momentum (Gill and Kharas, 2015; Agenor, 2016) it has become popular among policy makers and researchers.

Explanations of the middle-income trap can be divided into three broad categories. The first emphasizes the transition from a growth paradigm driven primarily by capital accumulation to one founded on a knowledge-based economy and growth of total factor productivity (Eichengreen et al., 2013; Abdychev et al., 2015). According to this interpretation, the middle-income trap arises from the progressive exhaustion of potential gains from capital accumulation and of underemployed labour, progressively weakening the country's growth prospects.[19]

This concept can be useful to understand some of the policy challenges for graduation with momentum.

The second interpretation focuses primarily on the evolution of a country's comparative advantage (Jankowska et al., 2012). As domestic labour costs increase, countries may become squeezed between lower-cost economies that progressively crowd out their labour-intensive exports and more sophisticated countries with greater competitiveness in high-value-added products. This suggests that the process of structural transformation is far from automatic, and that countries may become stalled at a middle level of export sophistication.

The third proposed explanation focuses on political and institutional frameworks, including the corrosive role of inequality on social capital and reform coalitions. According to this account, the transition to a knowledge-based society requires complex policies and considerable coordination, which may tax existing administrative capacities. This may be especially problematic where political capacities are weakened by the fragmentation of social groups and potential support coalitions (Keijzer et al., 2013; Doner and Schneider, forthcoming).

The middle-income trap highlights the key role of structural transformation in development.

None of these explanations, in itself, is fully satisfactory (UNCTAD, 2016b). However, they have a fundamental commonality: the central role of structural transformation in the development process. From an LDC perspective, the debate about the middle-income trap thus represents an important reminder of the imperative of maintaining the momentum of structural transformation, and of establishing the foundations for a viable future development trajectory as an integral part of graduation strategies. In particular, it demonstrates that the importance of structural transformation and the challenges to achieving it are not limited to the earliest stages of development, but remain throughout the course of development.

Appropriate macroeconomic, financial, STI , industrial and employment policies are needed to avoid the middle-income trap.

As elaborated in greater detail in chapter 5, overcoming these challenges requires:

- Supportive macroeconomic policies that address supply-side bottlenecks, while also stimulating aggregate demand;
- Financial policies that combine mobilization of resources for productive investment with adequate regulation and supervision;
- Industrial policies that foster the continuous development of productive capabilities, nurturing infant industries and fostering backward and forward linkages, to support a continuous upgrading of the sophistication of the productive base;
- Proactive science, technology and innovation policies that foster the emergence of a skilled workforce, in line with the needs of the labour market;
- Employment generation and redistributive policies, to strengthen popular support for a developmental agenda.

Box 4.2. The middle-income trap and LDCs' growth performance

The expression "middle-income trap" was originally coined with reference to the "uphill struggle" middle-income countries may face in maintaining a growth rate sufficient to converge towards the high-income level (Gill and Kharas, 2007:18). However, despite a growing literature on the middle-income trap, consensus on its definition and underlying causes remains elusive (Kanchoochat, 2015; UNCTAD, 2016b). Empirical assessments of its existence have adopted three broad approaches, although none is entirely free of possible econometric concerns or issues regarding its robustness (Agenor, 2016).

The first approach rests on the observation that transitions between income groups are relatively rare and occur only over long periods, resulting in a clustering of countries in the middle-income range (Spence, 2011; World Bank, 2013; Felipe et al., 2014). This is mirrored in the experiences of LDCs and LDC graduates: based on the Word Bank's classification, 33 LDCs and two of the four past graduates have remained in the same income category since 1987 (box table 4.1). Moreover, the few transitions that have occurred during this period have generally entailed a movement from low- to lower-middle-income level, while only two LDCs (Angola and Tuvalu) have reached the upper-middle level and one (Equatorial Guinea) the high-income level.

A second approach is to consider countries' convergence towards a benchmark advanced country. Studies using this approach have generally found a relatively low probability of middle-income countries converging towards the income level of the frontier economy (Im and Rosenblatt, 2013; Arias and Wen, 2016). Applying this approach to LDCs' long-term growth performance suggests that relative convergence is the exception rather than the rule. Box figure 4.1 shows the distribution of the 39 current LDCs for which data are available according to their income per capita relative to the United States. While the overwhelming majority of LDCs (34 of 39) had an income per capita exceeding 4 per cent of that of the United States in the 1950s, a growing number started to lag behind from the 1970s onwards. While some rapidly growing LDCs managed to reverse this divergence partially during the 2000s, others have fallen below the 2 per cent level.[1]

The third strand of empirical studies suggests that middle-income countries tend to be more prone to growth slowdowns than either high- or low-income countries (Aiyar et al., 2013; Eichengreen et al., 2013). Although the precise definitions of a growth slowdown vary among such studies, and are not aimed at capturing the specificities of LDCs,[2] this observation is clearly applicable to LDCs, whose growth performance has historically been erratic, being marked by a high incidence of both accelerations and collapses (UNCTAD, 2010). In the 1950–2010 period, LDCs on average experienced more than 20 years of declining real GDP per capita, compared with around 15 years for ODCs and fewer than 10 years for developed countries (box figure 4.2).[3] While growth rates were similar across the three groups in years of positive growth, the average contraction in LDCs (-4.0 per cent) was sharper than in ODCs (-3.7 per cent) or developed countries (-2.8 per cent).

[1] The experience of the two LDC graduates for which data are available, Botswana and Cabo Verde, is only slightly more encouraging. While these two countries experienced some long-term income convergence relative to the United States, this progress was not consistent, but punctuated by years of divergence.

[2] Unlike Aiyar et al. (2013), who examine deviations from the growth rate predicted by a standard neoclassical growth model, Eichengreen et al. (2013) define a growth slowdown as a period in which the seven-year average annual growth rate declines by at least 2 percentage points, having averaged at least 3.5 per cent in the previous seven years, in a country with GDP per capita greater than $10,000 (at 2005 international purchasing power parity).

[3] The analysis included in this paragraph and in the following two paragraphs is based on data from the Maddison Project database, which contains time-series data for real GDP per capita — measured in constant 1990 international dollars — for the period 1950–2010 (Bolt and van Zanden, 2014).

Box 4.2 (contd.)

Box table 4.1. Transition matrix across World Bank income categories, for LDC and LDC graduates

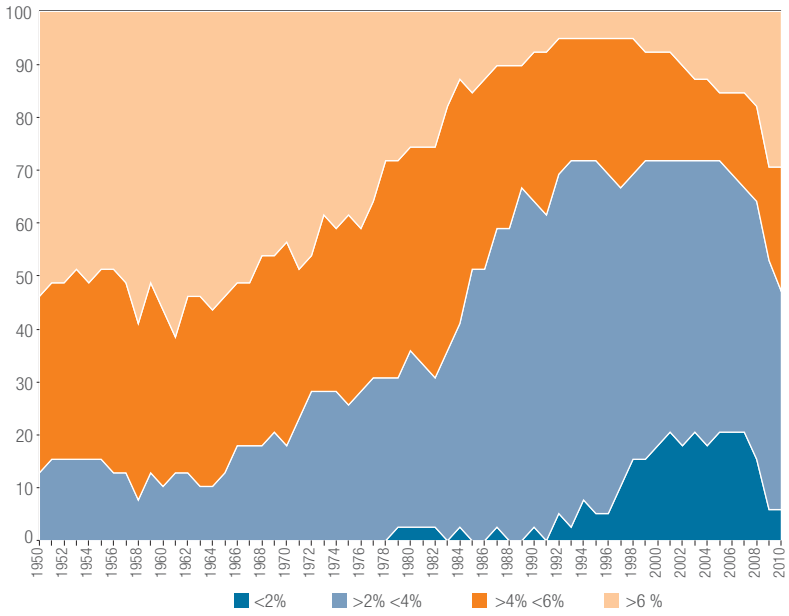
Current category 2016 / Starting category 1987	Low income	Lower-middle income	Upper-middle income	High income
Low Income	Afghanistan	Bangladesh	Angola (1988)	Equatorial Guinea
	Benin	Bhutan	**Maldives**	
	Burkina Faso	Lao People's Democratic Republic		
	Burundi	Myanmar		
	Cambodia	Sao Tome and Principe		
	Central African Republic	Sudan		
	Chad	Timor-Leste (2001)		
	Comoros	Zambia		
	Democratic Republic of the Congo	Lesotho		
	Eritrea (1992)	Mauritania		
	Ethiopia	Solomon Islands		
	Gambia			
	Guinea			
	Guinea-Bissau			
	Haiti			
	Liberia			
	Madagascar			
	Malawi			
	Mali			
	Mozambique			
	Nepal			
	Niger			
	Rwanda			
	Sierra Leone			
	Somalia			
	Togo			
	Uganda			
	United Republic of Tanzania			
Lower-middle income	South Sudan (2011)	Djibouti (1990)	Tuvalu (2009)	
		Kiribati	**Botswana**	
		Vanuatu		
		Senegal		
		Yemen		
		Cabo Verde (1988)		
		Samoa		

Source: UNCTAD secretariat calculations, based on http://databank.worldbank.org/data/download/site-content/OGHIST.xls (accessed June 2016).

Note: Unless data were available from 1987, the first year in which the country was included in the World Bank income classification is reported in the parenthesis.

Box 4.2 (contd.)

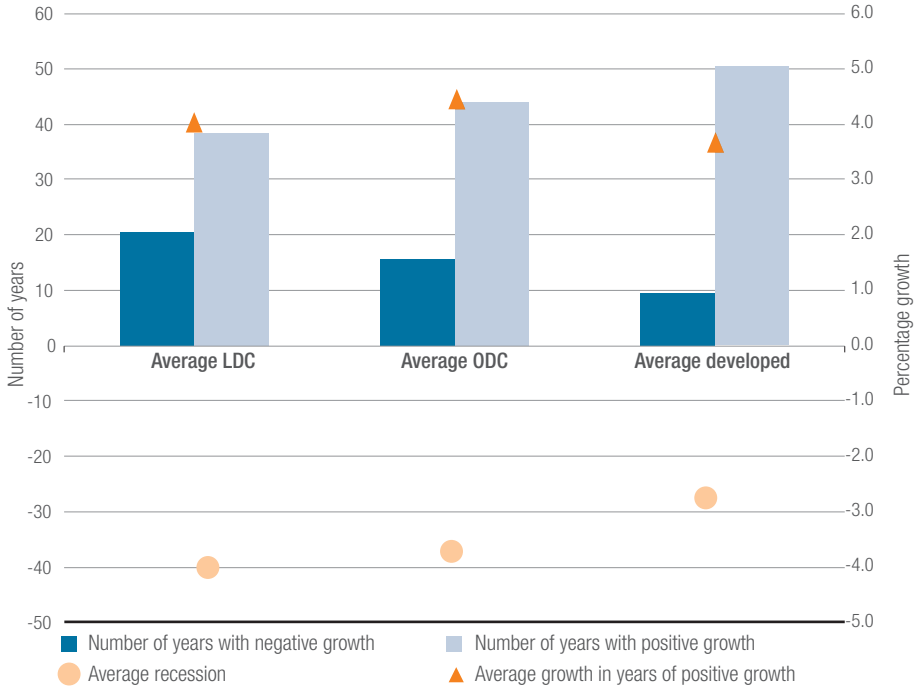
Box figure 4.1. Distribution of current LDCs in terms of GDP per capita relative to the United States



Source: UNCTAD secretariat calculations, based on data from the Maddison Project database (http://www.ggdc.net/maddison/maddison-project/home.htm), 2013 version (accessed June 2016).

Note: Data are only available for 39 current LDCs, except for 2009 and 2010 when only 17 LDCs are covered.

Box figure 4.2. Real GDP per-capita growth, 1950–2010



Source: UNCTAD secretariat calculations, based on data from The Maddison Project database (http://www.ggdc.net/maddison/maddison-project/home.htm), 2013 version (accessed June 2016).

E. The post-graduation development paths of the past graduates

The four countries that have graduated from the LDC category to date have maintained their development momentum since graduation. Not only has no graduate country suffered a reversal of its development progress sufficient to merit consideration for reinclusion in the LDC category, but all have continued to increase their national income and improve their human assets (table 4.4). Despite rapid growth, however, all four countries have remained very vulnerable economically and environmentally, their EVI indices remaining well above the threshold for inclusion in the LDC category even in 2015. Even Botswana,[20] which graduated from the LDC category more than 20 years ago, still has a vulnerability level similar to that of Samoa, a SIDS that graduated only in 2014. This highlights the major risk of continued vulnerability far beyond graduation, even in a context of an apparently very successful development process.

While all four past graduates have continued to increase national income and human assets, they remain economically vulnerable.

1. External debt

Figure 4.7 shows the level of external debt for all graduated countries relative to its level at the time of graduation. Indebtedness has increased substantially

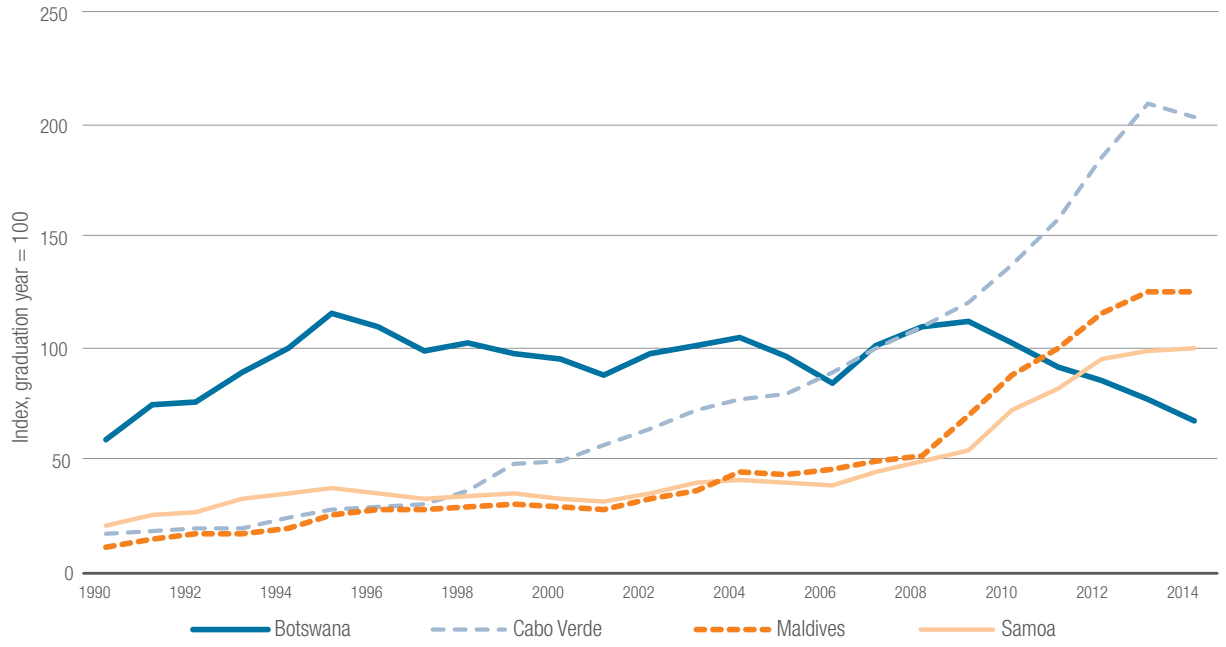
Indebtedness has risen substantially since graduation in all three recent graduates, though not in Botswana.

Table 4.4. Performance of graduated countries, 2015 indicators

	GNI per capita ($)	EVI	HAI
Threshold for inclusion	< $1 035	< 36.0	> 60.0
Threshold for graduation	> $1 242	< 32.0	> 66.0
Botswana	7 410	43.4	75.9
Cabo Verde	3 595	38.8	88.6
Maldives	6 645	49.5	91.3
Samoa	3 319	43.9	94.4

Source: CDP secretariat.

Figure 4.7. External debt level of the graduated countries, index, graduation year = 100



Source: UNCTAD secretariat calculations, based on data from World Bank, World Development Indicators database (accessed May 2016).
Note: The graduation years were as follows: 1994 for Botswana, 2007 for Cabo Verde, 2011 for Maldives and 2014 for Samoa.

in all three recent graduation cases. This trend is of particular concern in the case of Cabo Verde, whose debt has doubled since graduation, accelerating the increasing trend over the previous decade, to reach 86 per cent of GNI in 2014. External debt has also followed a strong upward trend in Maldives and Samoa, reaching 39 per cent and 58 per cent of GNI, respectively. This partly reflects increased expenditure for recovery and reconstruction following severe seismological and meteorological shocks, as well as the effects of the international financial crisis. In addition to expenditure for infrastructure reconstruction, both Governments have implemented several initiatives to provide income support and other assistance to affected households, as well as facilitating credit and subsidized lending.

Growing debt reflects persistent weaknesses in external balances.

Increasing debt in these countries appears to be a continuation of upward trends established in the pre-graduation phase rather than being attributable to graduation, but it is indicative of persistent weaknesses in their external balances. While their debt currently appears to be sustainable, use of debt-creating flows as a source of development finance in the face of inadequate ODA can give rise to an upward spiral of debt to unsustainable levels. This highlights the importance of identifying other financing options (UNCTAD, 2016a).

Botswana, by contrast, has succeeded in reducing its external debt in recent years, to an average of 15–17 per cent of GNI since the 2008 financial crisis — a level previously reached in the early 1990s. While this partly reflects debt forgiveness of $459 million in 2008, exceptional planning and Government management have also contributed to keeping debt relatively low.

ODA declined upon graduation, but remained relatively high in Cabo Verde and Samoa.

2. Official development assistance and foreign direct investment

Table 4.5 presents a comparison of ODA flows to the four graduate countries in the 10 years preceding graduation and the post-graduation period (limited to 10 years in the case of Botswana). This shows a systematic reduction in net ODA receipts relative to GNI following graduation, although the ratio remained high in Cabo Verde and Samoa, at 14 per cent and 12 per cent respectively. For the three recent graduates, however, this comparison is complicated by the relatively short periods since their graduation (especially in the case of Samoa) and temporary increases in ODA in response to acute external shocks during the pre-graduation period (for example, the devastating tsunami of 2004 in Maldives, which gave rise to considerable reconstruction needs in the following year).

FDI flows have increased, except in Botswana.

Table 4.5 also shows increases in FDI flows to the three recent graduate countries (though not Botswana) following graduation, particularly in the cases of Cabo Verde and Maldives. However, graduation itself is only one of many potential influences on such flows, including the introduction by some

Table 4.5. Net ODA receipts

	Net ODA as share of GNI		FDI as share of GDP	
	Pre	*Post*	*Pre*	*Post*
Botswana	2.9	1.3	2.5	2.2
Cabo Verde	18.2	14.0	5.5	8.0
Maldives	3.4	1.7	5.8	12.9
Samoa	12.4	12.0	2.8	3.3

Source: OECD Creditor Reporting System; World Bank, World Development Indicators database; UNCTADstat database (accessed August 2016).

Note: Ten-year average prior to graduation ("Pre" in the table) and ten-year average, or less, post-graduation ("Post" in the table). The post-graduation periods are: 1994–2003 for Botswana, 2007–2014 for Cabo Verde, 2011–2014 for Maldives and 2014 for Samoa.

governments of new laws aimed at attracting foreign investors, promoting domestic investment and facilitating entrepreneurial activities.

3. Economic diversification policies

The four graduates have achieved varying degrees of structural changes in their economies since graduation (table 4.6). The share of the primary sector in value added has decreased dramatically in all four cases, mainly to the benefit of the tertiary sector. In the three SIDS, this has been driven by tourism, reflecting their largely tourism-driven growth strategies. However, while these strategies have been successful in raising growth rates, they also appear to have increased export concentration, and may thus have intensified economic vulnerability.

The four graduates have achieved varying degrees of structural change…

The share of industry in value added decreased between the pre- and post-graduation periods in all cases except Maldives, where increased tourism-related construction raised the overall share of construction in GDP from 7 per cent to 11 per cent, more than offsetting a small decline in manufacturing. The reduction in the share of manufacturing in value added following graduation in all four cases, from already very low levels, is a matter of concern, and this trend may well continue.

Those countries that were dependent on one sector for their growth prior to graduation have remained dependent on the same sector since. The export concentration index of Cabo Verde and Maldives has been substantially higher in the post-graduation period than prior to graduation, reflecting increased dependence on tourist receipts (table 4.7). While data for such a comparison are unavailable for Botswana, it has remained heavily dependent on diamond exports. By contrast, Samoa's export concentration index has fallen substantially, reflecting an extensive programme to revitalize its agricultural and fishery exports. It should, however, be noted that the post-graduation period in this case covers only a single year.

…but they all remain dependent on the export sector that led them to graduation.

Table 4.6. Sectoral composition of gross value added, averages before and after graduation, selected countries

	Botswana		Cabo Verde		Maldives		Samoa	
	Pre	*Post*	*Pre*	*Post*	*Pre*	*Post*	*Pre*	*Post*
Agriculture, hunting, forestry, fishing	5.8	3.3	13.4	9.3	5.7	3.7	10.6	9.2
Industry	55.1	47.3	24.5	20.8	14.1	17.8	27.7	24.9
Manufacturing	6.3	6.2	7.3	6.2	5.4	5.3	13.1	10.0
Construction	7.0	6.2	10.0	12.2	7.0	11.3	10.7	10.1
Services	39.1	49.4	62.1	69.9	80.3	78.6	61.7	65.8
Wholesale, retail trade, restaurants and hotels	7.2	11.9	15.3	19.6	32.9	31.1	27.6	33.6
Transport, storage and communications	3.2	3.7	17.0	16.4	13.5	12.6	10.2	7.6
Other activities	28.7	33.9	29.8	34.0	33.9	34.9	23.8	24.6

Source: UNCTADstat database (accessed September 2016).
Note: Ten-year average prior to graduation ("Pre" in the table) and ten-year average, or less, post-graduation ("Post" in the table). The post-graduation periods are: 1994–2003 for Botswana, 2007–2014 for Cabo Verde, 2011–2014 for Maldives and 2014 for Samoa.

Table 4.7. Export concentration index, ten years pre- and post-graduation

	Pre	Post
Botswana	..	0.72
Cabo Verde	0.35	0.41
Maldives	0.52	0.73
Samoa	0.43	0.28

Source: UNCTADstat (accessed August 2016).
Note: As for previous table.

These results further underscore the continued vulnerability of the graduate countries to external shocks as a result of their narrow economic bases and minimal vertical and horizontal economic diversification. Even after graduation, sustained and sustainable growth thus requires policies to promote diversification into other activities, sectors and markets, and to enhance the competitiveness of domestic industries through systemic productivity improvements.

Graduates' experience underlies the need for policies to promote diversification even after graduation.

4. Poverty and inequality

Botswana achieved substantial poverty reduction after graduation, the headcount ratio declining from 34.8 per cent in 1993 to 18.2 per cent in 2009 - a rate of reduction significantly faster than that implied by Millennium Development Goal 1. While inequality increased (from an already very high level) between 1993 and 2002, it had fallen back to its 1993 level by 2009. Nonetheless, poverty remains high by the standards of ODCs, and inequality (as measured by the Gini index) remains among the highest in the world.

Botswana has achieved substantial poverty reduction since graduation, but inequality remains very high.

Data on poverty and inequality in the post-graduation period are unavailable for the three recent graduation, due to the relatively short periods since their graduation and the irregular nature and infrequency of household income and expenditure surveys. Data from around the times of their respective graduations indicates that poverty is moderate in Cabo Verde and Maldives, at 7–8 per cent, but less than 1 per cent in Samoa. Inequality is relatively low in Maldives, moderate in Samoa, and above average in Cabo Verde (table 4.8).

While all four countries have maintained relatively high education expenditures and achieved favourable educational enrolment rates, this has not produced the skilled workforce necessary to diversify their economies. The coexistence of unemployment (ranging 9.2 per cent in Cabo Verde to 18.2 per cent in Botswana in 2014) with vacant posts in the job market that employers find difficult to fill suggests a possible mismatch between educational curricula and labour market needs. The University of Botswana, for example, has reported significant mismatches between supply and demand in the labour market and highlighted concern about the job placement ratio (Nthebolang, 2013). There is a clear need for policies to reduce such skills mismatches as a means of crowding in private sector employment and reducing poverty and inequality.

Despite improvements in education in the graduates, skill shortages appear to persist.

Table 4.8. Poverty rates, Gini index and unemployment rate for the graduated countries, various years

	Poverty rates[a]	Gini index (per cent)	Unemployment rate, 2014
Botswana	18.2	60.5	18.2
Cabo Verde	8.1	47.2	9.2
Maldives	7.3	36.8	11.6
Samoa	0.8	42.7	..

Source: World Bank, World Development Indicators database (accessed August 2016).
Note: Data for the poverty rates and the Gini index for Botswana and Maldives refer to 2009, data for Cabo Verde refer to 2007, while data for Samoa refer to 2008. More recent data were not available.
a Measured using the poverty headcount ratio at $1.90/day (2011 purchasing power parity), % of population.

F. Summary

- While the smooth transition process can play a significant role in supporting graduation with momentum, good preparation and proactive engagement with development partners are critical.
- The prospect of a substantial increase in the number of graduation cases in the coming years highlights the need for the international community to define a more systematic and "user-friendly" set of smooth transition procedures.
- While graduation does not appear to cause sharp reductions in the availability of development finance, it may be accompanied by a reduction in concessionality and loss of access to climate finance.
- Loss of preferential market access at graduation may entail substantial costs, in the order of $4.2 billion per year across LDCs as a whole.
- Loss of eligibility for SDT provisions in WTO agreements may result in some shrinking of policy space following graduation, but this effect is limited by the narrow scope of such provisions and constraints on LDCs' capacity to exploit them effectively.
- Commodity dependence may persist after graduation; and a reversion to LDC status, though unlikely, cannot necessarily be ruled out.
- LDCs may be at particular risk of encountering a middle-income trap after graduation. Minimizing this risk requires graduation with momentum and early preparations to avoid the root causes of such traps.

Notes

1 The G20 is an international forum comprising the world's largest developed and developing economies, together accounting for some 85 per cent of global gross domestic product (GDP). The G20 members include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom of Great Britain and Northern Ireland, the United States of America and the European Union. Details of the coverage and methodology of the assessment of potential costs of losing LDC-specific preferential access are provided in annex 1.

2 The European Union extends preferential treatment under its Everything But Arms initiative to LDC graduated countries for an initial period of three years; and Australia, Canada, New Zealand, Norway, Switzerland and Turkey have applied some form of smooth transition procedures to past LDC graduates, as, to some extent, has the United States of America. At the other end of the scale, Japan applied most-favoured-nation (MFN) treatment to Maldives as early as six months after the country's effective graduation (CDP, 2012).

3 However, the empirical literature on the determinants of international financial flows has not investigated the impact of LDC status as such.

4 However, there do not appear to be any published studies formally testing the effect of LDC status on aid allocations.

5 The physical quality of life index is based on life expectancy at age 1, infant mortality, and literacy (Morris, 1980).

6 The other past graduate, Botswana, is no longer eligible for IDA lending.

7 The small-island exception allows a waiver to the IDA eligibility threshold for small islands that have a population less than 1.5 million, significant vulnerability due to their size and geography, and very limited creditworthiness and financing options.

8 For the fiscal year 2016, IDA eligibility threshold was $1,215, compared to an LDC graduation threshold of $1,242 (as applied in the 2015 triennial review).

9 In the case of Botswana, no ODA data are available for the pre-graduation period, that is to say, earlier than 1995.

10 As of July 2015, according to the WTO database, the following WTO members provided preferential arrangements of some kind to LDCs, either through specific schemes or as part of the broader GSP: Australia, Belarus, Canada, Chile, China, the European Union, Iceland, India, Japan, Kazakhstan, Kyrgyzstan, Morocco, New Zealand, Norway, the Republic of Korea, the Russian Federation, Switzerland, Tajikistan, Taiwan Province of China, Thailand, Turkey and the United States (http://ptadb.wto.org/ptaList.aspx, accessed 25 October 2016).

11 This is the case, for instance, in Canada, where most LDC graduates benefit from the General Preferential Tariff regime, and in the European Union, where they would ultimately become ineligible for the Everything But Arms initiative, but would continue to benefit from GSP or possibly GSP+ (unless they became high-income or upper-middle-income countries).

12 The key legal distinction in this respect is whether preferential market access originates from unilateral schemes (which in principle could be revoked at any time), or from bilateral/regional trade agreements. The former entail a somewhat lower degree of certainty and predictability, but are generally non-reciprocal, and thus impose no obligations on LDC members. The latter provide a greater degree of predictability, but tend to encompass some reciprocal obligations.

13 For example, graduation by those LDCs that have concluded EPAs with the European Union would arguably entail no significant change in their market access, as the EPAs envisage complete liberalization of European Union imports from signatory countries – that is, essentially the same market access that LDCs currently enjoy under the Everything But Arms initiative.

14 Exports diversification reduces the export concentration index, which is one of the components of the EVI.

15 Despite falling fuel prices, primary commodities on average represented three quarters of LDC exports in the period 2012–2015.

16 The only LDCs with current account surpluses over the 2012–2014 period are two fuels exporters (Angola and Timor-Leste); one mineral exporter (Zambia); two economies receiving large inflows of remittances (Bangladesh and Nepal); and one outlier service exporter (Tuvalu).

17 Unlike the World Bank income group classification on which this terminology is based (at least implicitly), the LDC criteria take into account a much broader set of dimensions,

encompassing 13 different socioeconomic, geographical and environmental indicators. However, as a result of their greater complexity and the technicalities of their application, the broader public and even policymakers tend to equate LDC graduation with the attainment of middle-income status, even though many LDCs are already classified by the World Bank as middle-income countries, and one (Equatorial Guinea) even as a high-income country.

18 The World Bank's income classification of countries is based on GNI per capita (computed using the Atlas method). As of June 2016, the income categories were defined as follows: low-income economies were defined as those with GNI per capita of $1,045 or lower; lower-middle income between $1,046 and $4,125; upper middle-income between $4,126 and $12,735; and high-income economies above $12,735. On this basis, 16 LDCs (Bangladesh, Bhutan, Djibouti, Kiribati, the Lao People's Democratic Republic, Lesotho, Mauritania, Myanmar, Sao Tome and Principe, Senegal, Solomon Islands, the Sudan, Timor-Leste, Vanuatu, Yemen and Zambia) are in the lower-middle-income group, two (Angola and Tuvalu) in the upper-middle-income group, and one (Equatorial Guinea) in the high-income group.

19 The originators of the concept of a middle-income trap argue that many of the challenges of middle-income countries are related to the transition between augmented Solow models and endogenous growth models, the former being better suited to characterizing the performance of low-income countries, and the latter to that of high-income countries (Gill and Kharas, 2015:14).

20 Up to 70 per cent of Botswana's territory is composed of the Kalahari Desert and only 5 per cent of its land mass is suitable for the purpose of arable agriculture.

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Annex 1. Simulation of the effects of loss of trade preferences due to graduation: Methodology

This annex outlines the methodology used for the analysis of the effects of trade preferences whose results are presented in the text. It extends Nicita and Seiermann's (2016) analysis of LDCs' export performance vis-à-vis 10 G20 countries and the European Union, which account for more than 70 per cent of total LDC exports, at the Harmonized System six-digit (HS6) level of product disaggregation.[1]

The methodology employed here follows three steps. First, a counterfactual post-graduation scenario is constructed on the basis of pairwise trade relations between each LDC and each G20 partner, replacing the tariffs currently faced by each LDC with those faced by the most similar non-LDC developing country in terms of preferential trade agreements with the G20 partners concerned, geographical location and level of development.[2] This yields a matrix of 418 (38 LDCs with available data multiplied by 11 trade partners) counterfactual tariff structures, each at the HS6 level of disaggregation, representing a situation in which LDCs no longer benefit from LDC-specific preferential treatment.

Second, potential changes in applied tariffs and preference margins are computed for each HS6 tariff line by comparing the current situation with the counterfactual scenario. Since graduation implies the phasing out of some preferential market access, the effect on tariffs is unequivocally negative; but the effect on preference margins is ambiguous. Technically, however, since each country's preference margin also depends on the tariff faced by other LDCs, its precise value at graduation point will depend on which of the other LDCs have already left the LDC category.[3] To bypass this potential complication, two alternative approaches are used to compute preference margins: (a) keeping the average tariff of the rest of the world constant at its current level, as if each given LDC were the first one to graduate; and (b) changing the tariffs faced by all LDCs simultaneously, to simulate the effect of all LDCs having graduated. In the first case, the effect of graduation on the preference margin is unequivocally negative, whereas in the second case it is ambiguous. The "true" effect of graduation will lie between these two extremes, and depend on when each country graduates relative to its LDC competitors (for the same HS6 product in the same export market).

Third, having thus obtained the simulated changes in tariffs and preference margins, the coefficients of the gravity model estimated by Nicita and Seiermann (2016) are used to derive the overall impact on export revenues. Since these impacts are initially obtained by export destination and product, and then aggregated, they take into account the three elements mentioned above, namely, the structure of existing preferential schemes; the export pattern and its product composition; and the fallback tariffs faced by each LDC upon graduation.

While the results reported here provide a reasonable order of magnitude for the potential effects of LDC graduation, three important limitations should be noted. First, the analysis captures only the first-round impact of changes in tariffs and preference margins on exports, and as such only considers effects on the exports of products traded with the same destinations before and after graduation. Second, they take no account of complications arising from limited utilization of preferential schemes or of interactions between the tariffs applied and non-tariff barriers, particularly rules of origin. Should LDC status allow countries to benefit from more flexible rules of origin, adverse effects of graduation may well be amplified by the requirement to comply with more stringent procedures. Third, the effect of preference losses will ultimately depend on the international trade landscape at the time of graduation, which may have changed significantly from the present. For example, to the extent that LDC preference margins are further eroded (for example, as a result of mega-regional trade agreements or other bilateral agreements negotiated in the meantime), the "commercial value" of their preferential treatment as LDCs will be reduced, thus also lowering the cost of graduation (that is, the potential reduction in export revenues arising from the loss of preferential market access following graduation).

1 The G20 members considered in the analysis are Argentina, Australia, Brazil, Canada, China, the European Union, India, Indonesia, Japan, Mexico, and the United States. The Republic of Korea, the Russian Federation and Saudi Arabia are excluded because the necessary data are unavailable, while the other members of the G20 are members of the European Union, and therefore included in the European Union data. Detailed tariff data at HS6 level are not available for the Comoros, the Democratic Republic of the Congo, Guinea-Bissau, Equatorial Guinea, Kiribati, the Lao People's Democratic Republic, Sao Tome and Principe, South Sudan, Timor-Leste and Tuvalu, so that only 38 of the 48 LDCs are included in the analysis.

2 The choice of the counterfactuals reflects the status of the AGOA and EPA negotiations as of June 2016, as reported respectively at http://agoa.info/about-agoa/country-eligibility.html and http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc_144912.pdf (both accessed 26 October 2016).

3 This can be seen by considering two LDC countries, X and Y, competing in a market to which they have preferential access. Intuitively, the loss of preferential treatment resulting from the graduation of X makes Y temporarily better off, so that its preferential treatment becomes "more valuable". However, this also implies a higher cost of graduation when country Y graduates and thus loses its preferential access.

Annex table A.1. Counterfactuals used in the analysis

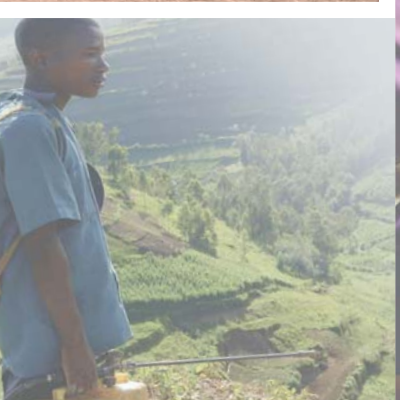
LDCs \ G20	Argentina	Australia	Brazil	Canada	China	European Union	India	Indonesia	Japan	Mexico	United States
Afghanistan	Tajikistan	Pakistan	Tajikistan	Pakistan	Tajikistan	Pakistan	Sri Lanka	Tajikistan	Pakistan	Tajikistan	Pakistan
Angola	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Botswana
Bangladesh	Pakistan	Pakistan	Pakistan	Pakistan	Sri Lanka	Pakistan	Pakistan	Pakistan	Pakistan	Pakistan	Pakistan
Benin	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Botswana
Bhutan	Tajikistan	Pakistan	Tajikistan	Pakistan	Tajikistan	Pakistan	Sri Lanka	Tajikistan	Pakistan	Tajikistan	Pakistan
Burkina Faso	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Burundi	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Botswana
Cambodia	Tajikistan	Viet Nam	Tajikistan	Viet Nam	Viet Nam	Pakistan	Viet Nam	Viet Nam	Viet Nam	Tajikistan	Viet Nam
Central African Republic	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Zimbabwe
Chad	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Gabon	Botswana
Djibouti	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Gabon	Kenya	Gabon	Botswana
Eritrea	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Gabon	Kenya	Gabon	Zimbabwe
Ethiopia	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Gabon	Kenya	Gabon	Botswana
Gambia	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Guinea	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Ghana	Botswana
Haiti	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Dominican Rep.	Haiti*
Lesotho	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana	Botswana
Liberia	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Ghana	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Madagascar	Botswana	Zimbabwe	Botswana	Zimbabwe	Zimbabwe	Zimbabwe	Botswana	Botswana	Zimbabwe	Botswana	Botswana
Malawi	Botswana	Botswana	Botswana	Botswana	Botswana	Kenya	Botswana	Botswana	Botswana	Botswana	Botswana
Mali	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Mauritania	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Mozambique	Zimbabwe	Botswana	Zimbabwe	Botswana	Botswana	Botswana	Zimbabwe	Zimbabwe	Botswana	Zimbabwe	Botswana
Myanmar	Viet Nam	Viet Nam	Viet Nam	Viet Nam	Viet Nam	Pakistan	Viet Nam	Viet Nam	Viet Nam	Viet Nam	Viet Nam
Nepal	Tajikistan	Pakistan	Tajikistan	Pakistan	Tajikistan	Pakistan	Sri Lanka	Tajikistan	Pakistan	Tajikistan	Pakistan
Niger	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Rwanda	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Botswana
Senegal	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Sierra Leone	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Solomon Islands	Fiji	Fiji	Fiji	Fiji	Fiji	New Caledonia	Fiji	Fiji	Fiji	Fiji	Fiji
Somalia	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Zimbabwe
Sudan	Egypt	Kenya	Egypt	Kenya	Gabon	Gabon	Egypt	Egypt	Kenya	Egypt	Zimbabwe
United Rep. of Tanzania	Zimbabwe	Kenya	Zimbabwe	Kenya	Kenya	Kenya	Zimbabwe	Zimbabwe	Kenya	Zimbabwe	Botswana
Togo	Côte d'Ivoire	Ghana	Côte d'Ivoire	Ghana	Ghana	Ghana	Côte d'Ivoire	Côte d'Ivoire	Ghana	Côte d'Ivoire	Botswana
Uganda	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Kenya	Botswana
Vanuatu	Fiji	Fiji	Fiji	Fiji	Fiji	New Caledonia	Fiji	Fiji	Fiji	Fiji	Fiji
Yemen	Oman	Oman	Oman	Oman	Oman	Oman	Oman	Oman	Oman	Oman	Saudi Arabia
Zambia	Botswana	Botswana	Botswana	Botswana	Gabon	Kenya	Botswana	Botswana	Botswana	Botswana	Botswana

Source: UNCTAD secretariat.
Notes: * tariffs were left unchanged in the counterfactual, because of bilateral arrangements with the respective G20 partner.

CHAPTER 5

The Path to Graduation and Beyond











A. Introduction

The 2011 Programme of Action for the Least Developed Countries for the Decade 2011–2020 (the Istanbul Programme of Action (IPoA)) included a target that half of the 49 countries with least developed country (LDC) status at the time should meet the statistical criteria for graduation by 2020. This was the first time that the international community had adopted an explicit target for graduation from the LDC category. Now, halfway from the setting of the target to the date for its attainment, it seems clear that it will not be met. The projections presented in chapter 2 of this Report suggest that only 16 (one third) of the current LDCs (in addition to Samoa, which graduated in 2014) can be expected to satisfy the full graduation criteria by 2021. This suggests that policies at the national and/or international level — that is, national graduation strategies and/or the international support measures (ISMs) for LDCs — have so far fallen significantly short of the expectations of the IPoA.

Several LDCs will meet the graduation criteria by 2021, but it seems clear that the IPoA graduation target will not be met.

However, this Report has argued that approaches to graduation should go beyond the minimum requirement — fulfilment of the statistical criteria (as discussed in chapter 1) — to aim for the more ambitious, but more substantive and sustainable, goal of "graduation with momentum". LDCs should seek not merely to qualify for graduation, but also to establish the essential foundations for their subsequent development, to avoid the traps and pitfalls of the later stages of the development process. It seems clear that not all of those countries that are projected to meet the statistical criteria for graduation by 2021 will have achieved this. While they may graduate by 2024, they may thus expect to remain subject, to some degree, to some of the structural weaknesses and vulnerabilities characteristic of LDCs even after graduation.

This raises the question of what can and should be done at the national and international levels, not only to accelerate progress towards graduation in line with the IPoA target, but also to ensure that those countries that reach graduation do so with the momentum needed to sustain them through the post-graduation development process. This is the theme of the present chapter. Following a further elaboration of the concept of graduation with momentum (section B), the chapter sets out elements of "graduation-plus" strategies to achieve this (section C). It then analyses how the international community can support such a process, both by ensuring a conducive global economic environment (section D) and by establishing effective ISMs (section E). The chapter concludes with a discussion of issues which might usefully be considered in reviewing the LDC criteria (section F).

How a country graduates is as important as when, to allow it to engage in global markets on an equal footing with ODCs.

B. Graduation with momentum

A recurrent theme throughout this Report has been the concept of graduation with momentum. This highlights the importance of viewing graduation as the first milestone in a marathon of development rather than the winning post in a race to escape LDC status,[1] and of focusing primarily on longer-term development processes rather than on the technicalities of the graduation criteria. While several countries close to the graduation thresholds have adopted graduation as a major national goal, as discussed in chapter 2, it is important that this is seen only as an initial step. The country's development process continues indefinitely beyond this point, and its subsequent success depends critically on the foundations built in the course of graduation. How graduation is achieved is thus as important as when it is achieved.

When an LDC graduates, it should have escaped from the vicious circles discussed in chapter 1 sufficiently to engage in international markets on an equal footing with other developing countries (ODCs), without relying on LDC-specific ISMs, for which it will no longer be eligible. As discussed in chapter 2, however, the extent to which the statistical criteria for graduation capture a country's ability to do this is open to debate. For example, none of the countries that have graduated to date has even now attained the graduation threshold for the economic vulnerability index (EVI), the graduation criterion that most closely reflects structural vulnerabilities (chapter 4). Thus, policies leading to graduation should not be aimed narrowly at achieving statistical eligibility, but rather oriented towards broader developmental goals. Equally, fulfilment of the criteria should be viewed, not as an object in itself, but rather as a by-product of an effective strategy oriented towards graduation with momentum. It is noteworthy that none of the four countries that have graduated from the LDC category to date adopted graduation as an explicit development goal (chapter 2). Rather, their actions towards graduation were essentially taken in response to recommendations of the Committee for Development Policy (CDP) and the initiation of the graduation process.

Productive capacities and structural transformation are critical to graduation and beyond...

UNCTAD's *Least Developed Countries Report* series has long ascribed LDCs' weak economic and social performance and persistent vulnerability to exogenous shocks to the limited development of their productive capacities (diversification and increasing sophistication of their productive bases) and slow and unbalanced processes of structural transformation (increasing productivity and reorientation of production from low-value-added to high-value-added sectors and activities). These shortcomings seriously limit LDCs' ability to derive developmental benefits from integration into the international economy (UNCTAD, 2006, 2014a). Their situation is aggravated by a volatile and often unfavourable international economic environment; and the existing ISMs have proven inadequate to counter these problems (UNCTAD, 2010). It is this combination of domestic and international shortcomings that has driven the divergence between the LDCs and ODCs documented in chapter 1 of this Report.

...but so far this is not fully captured in the statistical criteria for graduation.

Thus the keys to ensuring sufficient momentum at the point of graduation are the development of productive capacities and structural transformation of the economy. These are the primary means of redressing LDCs' structural handicaps (such as the poverty trap, the commodity-dependence trap and balance-of-payments constraints to growth, all examined in chapter 1), of coping with the adverse effects of geographical factors such as remoteness and landlocked location, and of establishing a more sustainable long-term development path. This emphasis is also closely aligned with the avowedly transformative 2030 Agenda for Sustainable Development (2030 Agenda), which includes explicit targets for both structural transformation and industrialization, and places greater emphasis on the interconnectedness of the economic, social and environmental pillars of sustainable development than did the Millennium Development Goals.

Beyond graduation, the possibility of falling into the "middle-income trap" (discussed in chapter 4) highlights the continuing importance of structural transformation and continuous development of productive capabilities throughout the course of development. This is further reinforced by global value chains (GVCs), which tend to realign patterns of trade and investment flows to divide production processes into ever-smaller segments based on existing comparative advantage, rather than fostering a *dynamic evolution* of comparative advantage (UNCTAD, 2015a: paras. 35–41).

Graduation with momentum is of particular relevance to those countries projected to graduate via the income-only route (Angola, Equatorial Guinea and Timor-Leste), whose remarkable growth performance during the commodity

super-cycle has led to little economic diversification or generation of productive employment. Such a trajectory provides at best a weak foundation for future development. Unless it is effectively directed to the development of productive capacities and economic diversification, even the sizeable wealth accumulated through fuel extraction may provide limited resilience to exogenous shocks. This has been highlighted by the sharp downward revisions of estimates for these countries' economic growth following the recent fall in commodity prices.

Graduation with momentum can offset the costs of losing access to LDC-specific ISMs…

Three factors may make the concept of graduation with momentum particularly appealing to LDC policymakers. First, while the costs of graduation arise directly from the graduation process itself, as ISMs are phased out at the end of the smooth transition period, its benefits arise from the improvement in socioeconomic conditions that underlies graduation. For example, the fact of graduation often entails some loss of preferential market access; but it is primarily the development progress underlying graduation that increases the country's capacity to mobilize domestic resources, to strengthen its financial system and to direct financing to productive investment. Thus, the extent of real development progress underlying graduation is an important determinant of the balance of its impacts.

…strengthen social and political coalitions in support of the country's development strategy…

Second, as can be seen from the past cases of graduation, it is a moment of national pride, conferring international recognition on the country's long-term developmental vision, and potentially strengthening the social and political coalitions supporting it. While the technicalities of the graduation process are remote from the general public, the inclusiveness of the pattern of growth leading to graduation plays a key role in ensuring its sustainability (UNCTAD, 2013a). By generating employment (particularly in non-traditional sectors) and raising incomes, policies aimed at economic diversification and productive-capacity development are likely to be more inclusive, and thus to engender greater domestic support.

...and help to address challenges and shocks beyond graduation.

Third, graduation with momentum is critical to addressing development challenges and coping with shocks in the post-graduation phase, after access to LDC-specific ISMs has been lost. As emphasized in chapter 4 of this Report, structural transformation, productivity growth and increasing sophistication of the economy are the driving forces behind convergence towards higher income levels throughout the course of development. They are thus of continued importance beyond graduation, to avoid the middle-income trap and build resilience to growth slowdowns, particularly in a context of continued geographical and/or structural vulnerability to economic and environmental shocks. Such vulnerability is highlighted by the experiences of past LDC graduates: while they have sustained their development trajectories without major disruptions since graduation, there are indications of persistent vulnerability, including rising debt levels, limited economic diversification, volatile official development assistance (ODA) flows, and in most cases moderate or high levels of poverty.

C. "Graduation-plus" strategies for graduation with momentum

National development strategies play a central role in "graduation-plus" strategies.

A more conducive international environment and more effective ISMs are critical to graduation with momentum (see sections D and E below). Nonetheless, as the Addis Ababa Action Agenda of the Third International Conference on Financing for Development emphasizes: "each country has primary responsibility for its own economic and social development and … the role of national policies and development strategies cannot be overemphasized" (United Nations, 2015: para. 9). It is thus incumbent upon the policymakers of each LDC to assume

full ownership of their country's development agenda, making the most of their respective circumstances and redoubling their efforts to leverage the existing ISMs effectively.

"Graduation-plus" strategies are needed, focusing on graduation with momentum…

The key importance of attaining graduation with momentum, rather than merely satisfying the statistical criteria, indicates a need to move from graduation strategies to "graduation-plus" strategies centred on a longer-term perspective and laying the foundations for the continuing development process. Such strategies should thus focus on the need for structural transformation, both before and after graduation, and apply different instruments and planning techniques to address the macroeconomic and sectoral challenges of development.

…starting from a diagnosis of constraints to growth and identification of economic opportunities...

A logical starting point for such strategies is to determine the factors that constrain the country's growth and to identify potential products and sectors of specialization and comparative advantage.[2] This can provide the starting point for the design and implementation of policy actions and programmes to overcome the former and to foster development of the latter. The international dimension of such an exercise can be addressed by the diagnostic trade integration studies produced under the aegis of the Enhanced Integrated Framework (EIF). The strategies, policies and programmes generated by these processes should be embodied in a long-term national development plan aligned with the Sustainable Development Goals, as a basis both for medium-term plans such as Poverty Reduction Strategy Papers and for donor alignment. UNCTAD's "Specializing smartly" toolkit can provide an important source of technical assistance (UNCTAD, 2016a).

…and optimizing use of ISMs.

An important part of graduation-plus strategies is an assessment of the country's use of ISMs and the constraints to more effective exploitation of the opportunities they provide, to optimize the utilization and developmental impacts. It is also important to plan for the phasing-out of access to these ISMs following graduation, including through the identification of alternatives (for example, non-LDC-specific preferential market access instruments).

Key areas of "graduation-plus" strategies are rural transformation, industrial policy, STI, finance, macroeconomic policy, employment and gender.

It should be emphasized that the policies adopted as part of a graduation-plus strategy in any country must reflect its own particular circumstances and priorities and be adapted to its institutional framework and capacities, as one-size-fits-all approaches may be counterproductive. Nonetheless, some types of policies can be identified as being of particular relevance to graduation with momentum, having been identified in previous editions of *The Least Developed Countries Report* as fundamental to accelerating the development of productive capacities through capital accumulation, technological progress and structural change (UNCTAD, 2006: chap. II.1). While such policies are closely interrelated in their contribution to graduation with momentum, they are grouped into six broad areas for presentational purposes: rural transformation; industrial policy; science, technology and innovation (STI); finance; macroeconomic policy; and employment generation. Gender is also a key issue, cross-cutting these and other policy areas.

1. Rural transformation

Rural development is a critical dimension of structural transformation in LDCs. Two thirds of the LDC labour force is employed in agriculture, which also plays a critical role in the supply of inputs and wage goods, and in domestic demand for the output of other sectors. In the context of the 2030 Agenda, the importance of rural development is further increased by its role in Sustainable Development Goals 1 ("End poverty in all its forms everywhere") and 2 ("End hunger, achieve food security and improved nutrition and promote sustainable agriculture"). An accelerated and broadly based transformation of rural economies is thus

central to the process of poverty-oriented structural transformation essential to achieving the Goals (UNCTAD, 2015b).

Redressing chronic underinvestment in agriculture is a key priority for most, if not all, LDCs. With due consideration of each country's specific needs, this is likely to require a combination of the following mutually supportive elements:

Rural development requires redressing chronic under-investment in agriculture…

- Appropriately sequenced investment in key elements of infrastructure, notably electrification, irrigation, drainage, water supply, storage facilities and road networks;
- Upgrading farming technologies and practices, to enhance productivity and sustainability;
- Financing research on improved and more resilient seeds and cultivation techniques, and deploying extension services throughout agricultural areas to provide technical assistance and foster the adoption of such seeds and techniques, particularly by under-resourced small producers;
- Actively assisting smallholders or producers with limited access to finance and technology in raising their productivity and upgrading their production, for example through support to producers' associations and cooperatives, programmes to improve access to credit and appropriate land-titling policies.

…and it results in diversifying rural economies through promotion of non-farm activities.

For certain agricultural products, it may be beneficial to complement support for local transformation with dedicated technical assistance to allow small producers to connect to GVCs on more favourable terms, as in the case of Ethiopian coffee producers under the Ethiopia Trademark and Licencing Initiative (Balgobind, n.d.). In this context, graduation with momentum is also likely to require measures to redress the limited availability of skills, for example through appropriate vocational training schemes and initiatives to match school curricula with the market's needs.

Diversification of the rural economy through the promotion of rural non-farm activities also plays an important role, given the complementarities between agriculture and the rural non-farm economy. It provides a source of demand for agricultural outputs and of finance for agricultural investment; facilitates the supply of agricultural inputs; and can increase the tradability of agricultural produce and provide opportunities for greater value addition.

The development of non-farm activities also allows producers to diversify their income sources beyond agriculture, to smooth their incomes over time (particularly across seasons), and to diversify risks related to their productive activities. It can thus also help to reduce risk aversion, which is a major impediment to agricultural investment and technological innovation. Coordinated measures to promote rural non-farm activities in tandem with agricultural upgrading, maximizing the synergies between the two, can thus play a critical role in rural development strategies. These measures include the mutually supportive elements listed above with policies to support rural entrepreneurship by choice (rather than by necessity) and the creation of employment through rural infrastructure works (UNCTAD, 2015b).

There is scope for both "vertical" and "horizontal" industrial policies to tackle market failures.

2. Industrial policy

There is a growing consensus that structural transformation does not occur automatically, but rather requires proactive policy action to address the widely recognized obstacles to the shifting of production to new sectors and activities with higher productivity and greater technological potential. This also relates to the spillovers, informational asymmetries and coordination issues that impede innovation and price-discovery processes (UNCTAD, 2010, 2014a, 2016d;

UNECA, 2015a). In this context, there is scope for both "vertical" (sectoral) and "horizontal" (functional) policies to tackle specific market failures across sectors. By beginning from the country's existing capacity, and fostering the emergence of backward and forward linkages, such policies can contribute significantly to increasing value addition. Bolder and more strategic industrial policy frameworks, including in STI (subsection 3, below), could also enable LDCs to harness more fully such policy space as is available to them.

Industrial policies need to strike a balance between current comparative advantage and increasing sophistication.

In seeking to "nudge" producers to move from lower- to higher-productivity sectors, LDC policymakers need to strike a balance between exploiting more intensively those productive activities that are consistent with current comparative advantage and encouraging the expansion of activities at progressively higher levels of sophistication. This represents a combination of what have been called "passive" with "active" industrial policies (UNCTAD, 2016d: chap. VI). A second challenge is to devise industrial policy strategies in such a way as to ensure that support for emerging activities does not promote rent-seeking behaviours. Potentially useful approaches to this issue include (a) sunset clauses, to ensure that support does not become entrenched; (b) a combination of "carrots" and "sticks", penalizing losers as well as rewarding winners; and (c) institutional arrangements that ensure a high degree of accountability in the conduct of industrial policy.

3. Science, technology and innovation policy

STI capabilities are needed to absorb, adapt and develop technologies...

Structural transformation in LDCs requires building capabilities in STI, which are critical to closing the productivity gap between LDCs and more advanced economies. Such capacities play two distinct roles. First, they contribute to a catching-up process, increasing efficiency in the use of productive resources by moving production processes closer to the technological frontier, and thus also improving competitiveness. Second, they play a fundamental role in fostering the emergence of new activities that offer high value-added and growth potential, allowing the country to reap the benefits of dynamic gains from trade. These processes occur through a combination of absorption and adaptation of imported technologies and development of indigenous technological capacities.

...which requires a conducive policy framework.

However, this process is far from spontaneous, and requires a conducive policy framework. A key objective of such a framework is to increase capacity for the absorption of more sophisticated technologies imported or transferred from other countries and to adapt them to local conditions. This can help LDCs to reap some of the strategic opportunities offered by technology-related ISMs, such as the extension of the transition period for their implementation of the World Trade Organization (WTO) Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement) and support for technology transfer under the Agreement's article 66.2 (see section E.4 below). Increasing capacity for absorption and adaptation of imported technologies requires, inter alia, the development of a pool of skilled and talented labour through vocational training, tertiary education and competence-building, especially in engineering, science and mathematics.

In the Addis Ababa Action Agenda, governments committed themselves to adopting STI strategies as an integral element of their national sustainable development strategies, and to crafting policies to incentivize the creation of new technologies and research and to support innovation (United Nations, 2016b). Given the interconnection between STI policy and industrial policies, this requires an integrated approach to the two areas, to promote the emergence of viable and progressively more sophisticated activities, notably in manufacturing and modern service sectors.

However, STI tends to be a neglected policy area in many LDCs. Moreover, the objectives of fostering innovation and promoting structural transformation have often been pursued by different institutions with weak coordination, resulting in gaps, redundancies and inconsistencies in industrial and STI policies (UNCTAD, 2015c). The experiences of several LDCs highlight the need for a more strategic approach, in order to boost absorptive capacities and harness intellectual property to promote radical innovation and technological leap-frogging (UNCTAD, 2012a, 2015c; UNECA et al., 2016). However, technological learning and innovation need to be appropriate to each country's level of technological development, its economic structure and the capabilities of its public institutions and private sector (UNCTAD, 2007).

STI tends to be a neglected policy area in many LDCs.

While the policies appropriate to each LDC are clearly dependent on its particular circumstances, some general observations may be made, particularly in terms of priorities and institutional arrangements.

In order to be effective, STI policies need to be coordinated with policies in other areas, including education, competition, regulation, tax, development finance, international trade, investment and public-sector management. Effective coordination is thus important to improve policy coherence in the conceptualization and design of STI policies, to articulate their linkages to the country's broader development vision, and to integrate them effectively with industrial and other policies.

STI capabilities also depend on the quality of interactions among actors in the innovation system.

STI capabilities depend not only on the existing stock of technological knowledge, but also on the quality of interactions among actors that are part of the innovation system, particularly between institutions of research and advanced education and domestic and foreign firms, to improve absorptive and innovative capacities (United Nations, 2016a). Measures to strengthen such interactions at an economy-wide level might include, for example, the creation of national online knowledge and learning resources to allow enterprises, researchers and domestic and foreign universities to interact and exchange ideas, and to network on STI-related issues. National intellectual property systems can encourage national firms and advanced educational institutions to engage in technological learning and local research and innovation. Sector-specific initiatives to foster technology transfer, incentivize joint ventures, and promote closer collaboration between domestic firms and foreign investors can also make a major contribution, by increasing domestic value addition and strengthening backward and forward linkages (UNCTAD, 2012a).

Regional and South-South cooperation can play an important role in STI strategies, as well as ODA.

As well as ODA, regional and South–South cooperation can play an important role in STI strategies. Pooling scarce resources, at regional and/or subregional levels, could allow the establishment of joint research and technology incubator facilities and the implementation of joint research projects. This has been done in the agricultural sector through research institutes coordinated by the Consultative Group on International Agricultural Research, such as AfricaRice, the International Institute of Tropical Agriculture, the International Livestock Research Institute and the International Maize and Wheat Improvement Center. In all these cases, LDCs participate in the research efforts and derive benefits from research results.

Equally, there are growing opportunities for South–South technology transfer. Knowledge flows and technical cooperation have become major components of South–South economic relations, diversifying the sources of knowledge transfer and partnership for LDCs (UNCTAD, 2010: chaps. 4, 7; UNCTAD, 2012a). South–South technology transfer is complementary to North–South knowledge flows, the two sometimes being combined in triangular cooperation, whereby South–South knowledge flows are facilitated and boosted by developed country donors (UNDP, 2009).

4. Development finance

Finance plays a fundamental role in productive-capacity development, mobilizing domestic and foreign resources and intermediating them in support of transformative productive investment and technological upgrading (McMillan et al., 2014). The need to reinforce domestic resource mobilization, strengthen the fiscal base of LDCs and curb illicit international financial flows has been repeatedly stressed, both by UNCTAD (2014b, 2015d) and by the international community as a whole (for example, in the Addis Ababa Action Agenda).

Finance plays a fundamental role in productive-capacity development.

For most LDC firms, the bulk of investment financing is initially from internal resources. However, to grow and upgrade their productive capacities, firms need to shift towards bank financing, which requires an efficient banking system. Development banks and central banks have an essential role in ensuring that finance is available for long-term investment, as it is only at higher levels of dynamic growth and development that a profit-investment nexus can be established (UNCTAD, 2016d: chap. V). This process also strengthens the country's attractiveness to foreign investors, through its effects on determinants of foreign direct investment (FDI) allocation such as macroeconomic fundamentals, institutional factors and cost competitiveness.

A greater transformational impact is likely to be achieved through development banks, which can foster agricultural modernization and industrial upgrading, following the model of some newly industrializing countries (UNCTAD, 2015b, 2015d: chap. VI). Their role in financing long-term development and structural transformation has been recast in a more positive light since the outbreak of the financial and economic crisis of 2008 (Griffith-Jones et al., 2016a). Ethiopia has long made use of its national public development bank (the Development Bank of Ethiopia) to provide long-term credit (for example, to manufacturing and structural transformation), contributing to the country's structural transformation (Griffith-Jones et al., 2016b).

Development banks can have a transformational impact.

There is also scope to strengthen the surveillance and regulatory framework of the financial sector, to enhance trust and mobilize savings more effectively. Improvements to the overall institutional framework underpinning the credit market — for example, improving credit report systems and property titling — may also help to broaden credit provision by reducing risks to lenders.

Despite accelerated progress in recent years, largely as a result of mobile banking systems, financial inclusion remains very limited in most LDCs. Many people remain unbanked, particularly among rural populations, those living in poverty, women and young people. Programmes to address the constraints to access to financial services among poor rural populations, such as the United Nations Capital Development Fund's (UNCDF) MicroLead programme (box 5.1), can make an important contribution to addressing this issue.

Despite accelerated progress and new opportunities opened by ICT penetration, financial inclusion remains very limited in most LDCs.

Lack of access to credit can be a major challenge, particularly for microenterprises, small and medium-sized enterprises (SMEs) and smallholder farms, an overwhelming majority of which are credit rationed (UNCTAD, 2014a, 2015b). Policymakers can consider using credit allocation to provide support to credit and savings cooperatives. Microfinance is potentially useful to support microenterprise, but unlikely to be sufficient.

In many LDCs (such as Bangladesh, Senegal, the United Republic of Tanzania and Uganda), information and communications technologies (ICTs) are opening up new opportunities for domestic resource mobilization beyond the traditional banking sector, notably through mobile banking and money transfer services (UNCTAD, 2012b: chap. 3). Such mechanisms have considerable potential, particularly where the outreach of formal banks is inadequate, and in a context

Box 5.1. UNCDF's MicroLead and MicroLead Expansion programmes

UNCDF's MicroLead and MicroLead Expansion programmes have been in operation since 2009, with support from private philanthropic sources. Through these programmes, UNCDF is seeking to extend the frontier of finance into unbanked communities by investing in delivery innovations, including a variety of digital channels, agent networks and community-based savings groups. While these programmes are not exclusively dedicated to LDCs, 18 of the 21 countries in which they are active are LDCs (Benin, Bhutan, Burkina Faso, Burundi, the Democratic Republic of the Congo, Ethiopia, the Lao People's Democratic Republic, Liberia, Malawi, Myanmar, Rwanda, Sierra Leone, Solomon Islands, South Sudan, Timor-Leste, Uganda, the United Republic of Tanzania and Vanuatu), while one (Samoa) is a graduate from the LDC category.

The MicroLead and MicroLead Expansion programmes focus on providing safe, secure deposit accounts to unbanked and under-banked populations. Through the MicroLead Expansion programme, UNCDF is challenging formal financial service providers to reach rural unbanked populations, particularly women, with deposit products and financial education, both tailored to these unbanked populations' needs. By deploying alternative delivery channels, such as agency banking and digital financial services, and working predominantly through informal groups, the programme has increased understanding amongst financial institutions and their capacity to serve those who were previously considered unbankable. Its savings-led financial inclusion strategy has the potential to make a significant contribution in countries where exclusion is widespread and financial depth is limited. As of June 2016, MicroLead Expansion had reached more than 650,000 active clients with savings accounts and other services through the use of technology, alternative delivery channels, and informal savings group linkage models. 80 per cent of these active accounts were located in LDCs. By the end of the programme (scheduled for June 2017), it is expected to reach more than 1.3 million active customers in 11 countries, while moving further into rural markets with demand-driven, responsibly priced products.

Women are an important beneficiary group of the MicroLead Expansion programme, representing more than 70 per cent of its active clients. A meta-analysis of evidence from randomized control trials shows consistently positive economic outcomes as a result of increased access to savings, particularly for rural women, including increasing their productivity, profits and investment, as well as reducing asset sales to address health emergencies, improving consumption smoothing in the face of economic shocks, and increasing their legal and psychological control over funds (Buvinic and Furst-Nichols, 2014). Digital financial services also support women's participation in the labour force and increase their financial autonomy (GPFI, 2015).

Source: UNCDF.

of substantial rural–urban migration. Innovative approaches may be helpful in tailoring such financial services to the particular needs of potential customers, although the need for an adequate regulatory framework to ensure the reliability and integrity of the system should not be overlooked.

5. Macroeconomic policies

Macroeconomic policy frameworks should combine stability with investment dynamism and employment generation.

A development-oriented macroeconomic policy framework should combine macroeconomic stability with investment dynamism and employment generation. While sound macroeconomic fundamentals are part of an enabling environment for development, they are not sufficient to spur structural transformation. Graduation with momentum in most cases requires a considerable scaling up of investment to address the infrastructural and technological gaps that undermine both productivity and competitiveness and leave many LDCs exposed to structural vulnerabilities (as seen in chapter 1). The long-standing investment needs of LDCs are now magnified by two additional demands: first, to fulfil the social objectives of the Sustainable Development Goals, which will require considerable investment, especially in rural areas (UNCTAD, 2015b); and second, to meet the increased need for resilient infrastructure as a result of climate change. While recent trends indicate that LDCs have achieved an overall ratio of investment to gross domestic product (GDP) above the 25 per cent level deemed necessary for sustained economic growth (Introduction to this Report), maintaining this progress in the face of a slowing global economy remains a key challenge.

Investment needs are increased by the SDGs and the need for climate change adaptation.

Fiscal policy has a key role to play in this context, both in financing public investment directly and through its potential to crowd in private investment in productive sectors. Particularly beneficial in the latter regard are strategic infrastructure projects to address bottlenecks that constrain the productive

sector. Public investments in road networks and electricity provision in African countries such as Ethiopia, for example, demonstrate the potential for such projects to enhance firms' competitiveness and unlock supply responses (Oseni and Pollitt, 2013; UNCTAD, 2015b). By using labour-intensive construction techniques where appropriate, infrastructure projects can also generate substantial multiplier effects, thereby contributing significantly to employment generation and inclusive growth (UNCTAD, 2013a: chaps. 4, 5).

Strategic infrastructure investments can crowd in private investment by easing supply constraints…

However, in most LDCs, an increase in public investment on the necessary scale would require broadening the available fiscal space. As well as considerable improvements in taxation and revenue collection systems, this requires reforms to broaden the tax base and diversify public revenues sources; elimination of exemptions and regulatory loopholes; reinforcement of property taxation (especially in urban areas); and reducing tax evasion (UNCTAD, 2009a, 2014a: chap. 6). For those LDCs with abundant natural-resource endowments, it is also important to capture a greater share of resource rents. In particular, this requires avoiding a "race to the bottom" to attract resource-seeking investors and strengthening regulatory frameworks to prevent illicit financial flows related to trade mis-invoicing (UNCTAD, 2014b: chap. VII). Botswana may be regarded a success story in this respect, in that its State has successfully captured a major share of mining rents, which it has devoted to funding economic diversification (chapter 1).

…but increasing investment requires broadening fiscal space.

Accelerated progress in this direction is critical to graduation with momentum, to reduce aid dependency and prepare graduating countries to cope with post-graduation changes in their development finance landscape.

The effect of a proactive fiscal stance could be enhanced by the adoption of accommodative monetary policies, shifting away from a narrow focus on price stability, especially while inflationary pressures are continue to be dampened by low international commodity prices. Monetary policy should take full account of the implications of national circumstances, notably policy regimes and financial development, for transmission mechanisms (UNCTAD, 2009b: chap. 2; Berg et al., 2013). Given the limited availability of credit to the private sector, due attention should also be given to the impact of monetary policy decisions on credit aggregates, and not only on interest rates.

A proactive fiscal stance can be more effective with accommodative monetary policies.

Although a competitive exchange rate can be an instrument for the maintenance of export competitiveness, its use for this purpose is constrained in most LDCs by a combination of import sensitivity, structural current account deficits and external debt (chapter 1). Exchange rate stability may be enhanced through the appropriate use of capital controls and/or taxes on inflows of equity and portfolio investment, both to reduce the volatility of private capital flows and to increase their contribution to the achievement of overall development objectives. Ethiopia, for example, has traditionally limited its international financial vulnerability by limiting its opening to capital inflows mainly to FDI and government borrowing on international bond markets, while also making use of outflow controls (Alemu, 2016). Angola, the Democratic Republic of the Congo and Mozambique, among others, have implemented stronger controls on capital inflows than the sub-Saharan African average, while Burkina Faso, Guinea-Bissau and Senegal have put in place stronger-than-average controls on capital outflows (Massa, 2016).

Exchange rate stability can be enhanced through capital controls.

6. Employment generation

Graduation with momentum requires LDCs to generate jobs on a substantially larger scale than in the recent past, to provide productive employment for the growing cohorts of young entrants to the labour market, and thus to reap

the demographic dividend (UNCTAD, 2013a). The need for poverty-oriented structural transformation in LDCs to achieve the Sustainable Development Goals also requires employment creation to be combined with increased labour productivity (UNCTAD, 2014a). "[F]ull and productive employment and decent work for all" is not only explicitly included in the Sustainable Development Goals (Goal 8), but is also closely related to Goals 1 (poverty eradication) and 10 (reduced inequalities).

Employment creation is as imperative as productivity increases...

This combination of employment creation and increased labour productivity can be promoted by a three-pronged strategy:

- A transformative rural development agenda, synchronizing increased agricultural productivity with the complementary development of rural non-farm activities;
- Support to the development of microenterprises and SMEs, including by improving their access to capital and technical assistance on managerial and technology issues, and facilitating formalization;
- Public-sector-led employment creation, notably through the use of labour-based construction methods in large-scale infrastructure projects where appropriate.[3]

Complementary measures are also needed in education, including improvement of vocational training and reform of school curricula to increase their relevance to the needs of the labour market and the economy as a whole.

…requiring rural transformation, enterprise development and public-sector-led employment creation.

7. Gender

The structural transformation and development of productive capacities required for graduation with momentum will inevitably be limited to the extent that certain population groups are constrained in their ability to engage in economic activities. A particularly important dimension of this broader issue of inclusivity is gender, as women constitute half of the human resource base and are systematically disadvantaged in most LDCs (chapter 1). Women's engagement in economic activities is constrained by a wide range of obstacles to their access to labour and other markets, and to education, which interact with other market imperfections to diminish their productivity and entrepreneurial potential. Only if these constraints are addressed can the supply response to incentives aimed at increasing production be fully effective. Key issues are equal access for women to education, employment and other economic opportunities, finance and factors of production.

Structural transformation and productive-capacity development are limited by gender inequality and economic exclusion.

Thus, policies cannot be fully effective in promoting development and contributing to graduation with momentum unless women are empowered to realize their potential economic contribution to a much greater extent than is generally the case in LDCs at present. Consequently, reducing gender inequality needs to be a cross-cutting consideration across all policy areas, including (but not limited to) those discussed above.

Appropriate strategies in this area are particularly dependent on local circumstances, given the role of locally-specific cultures and traditions in many discriminatory practices. In general, however, tackling gender inequality requires a combination of policies, which are important both before and after graduation. These include:

- Actions to remove de facto discrimination in existing public policies and institutional frameworks (for example, educational systems, agricultural extension services, procedures for formalization of enterprises and land titling);

- Efforts to ensure that new policies and interventions do not lead to such discrimination, and where appropriate are skewed towards women in such a way as to counter the disadvantages that they face (for example, in public employment, support to smallholder farmers and microenterprises and small enterprises, and support to producer groups and cooperatives);
- Implementation of policies and other interventions to counter market mechanisms that lead to gender-differentiated outcomes (for example, in employment markets and access to finance);
- Proactive efforts to identify and harness new opportunities to counter the obstacles and disadvantages faced by women (for example, the spread of access to the Internet and mobile telephone networks, and the emergence of related financial services).

D. The international environment

The global economic environment for LDCs has become more challenging since 2008, and may deteriorate further.

As discussed in chapter 2, LDCs' economic performance is extremely vulnerable to changes in the international environment. Their exposure to exogenous shocks originating from the fluctuations of international markets is accentuated by geographical challenges, high levels of export concentration and commodity dependence, structural dependence on foreign savings and high (though declining) aid dependence.

While the economic environment for LDCs was relatively favourable in the years after 2000, reflecting global economic conditions (UNCTAD, 2010: chap. 1), it has been considerably less conducive to their development since the global financial and economic crisis. Following some encouraging signs of resilience in the immediate aftermath of the crisis, the uneven global recovery and slow world demand growth have since impacted on LDCs' economic performance (as discussed in the Introduction). Moreover, the external environment may well deteriorate further, if the effects of anaemic global demand and weak commodity prices are compounded by increased financial volatility. UNCTAD has already highlighted the dangers of mounting external and internal debt in a number of African LDCs (UNCTAD, 2016b). Further downside risks may stem from growing exchange rate volatility, most notably of the euro, whose effects are directly transmitted to those African LDCs in the CFA franc zone.

Reducing commodity price volatility and reforming the international financial architecture would greatly contribute to improving the economic outlook for LDCs...

There is little doubt that a more stable and development-oriented international environment would contribute greatly to improving the economic outlook for LDCs. Such an environment should include, in particular, the resolution of two issues long highlighted by UNCTAD: volatility in commodity markets and the absence of a multilateral debt structuring mechanism (UNCTAD, 2010, 2015d). Less volatile and more predictable commodity markets would reduce the uncertainty of LDC export revenues and current account balances, as well as facilitating the mobilization of resource rents for the development of productive capacities (UNCTAD, 2008: chap. II; Nissanke, 2011).

...including by establishing a multilateral debt restructuring mechanism.

Capital-scarce LDCs would also gain considerably from reform of the international financial architecture to redress its chronic instability, tackle the current crisis and address their particular vulnerabilities and concerns (UNCTAD, 2015d). Of particular importance to these countries is more stable and predictable provision of international liquidity, to enhance their access to development finance and allow them to address their distinctive needs (UNCTAD, 2014a). While official finance is only one of the pillars of resource mobilization, the recent decline in ODA disbursements to LDCs is a source of concern, especially in the context of the Sustainable Development Goals. Similarly, while the external debts of many LDCs were reduced through the Heavily Indebted

Poor Countries Initiative and the Multilateral Debt Relief Initiative, recent trends indicate that they would benefit considerably from the establishment of a multilateral debt restructuring mechanism, as well as from the ongoing reform of the debt sustainability framework. In order to contribute to international policy action, UNCTAD has formulated a coherent set of principles for sovereign debt resolution mechanisms (UNCTAD, 2015d: chap. V).

Strengthening regional integration and forging stronger financial and trading partnerships within the global South can also contribute to a more supportive international environment, both for LDCs and for graduates from the LDC category. Exports to regional and other Southern markets tend to be more sophisticated than those to developed country markets, providing greater scope for growth and structural transformation (Klinger, 2009; UNCTAD, 2010; UNECA, 2015a). Deepening regional integration could be particularly beneficial to LDCs in Africa, where negotiations for the establishment of a Continental Free Trade Area are underway and member countries of the Common Market for Eastern and Southern Africa, the East African Community and the Southern African Development Community have already reached an initial agreement on the establishment of a tripartite free-trade area (Mevel and Karingi, 2013; UNECA, 2015a).

Stronger regional integration and South-South cooperation can contribute to graduation with momentum in the financial sphere as well as in trade.

Likewise, closer regional cooperation in the financial sphere could contribute significantly to resource mobilization for the development of productive capacities. Potentially beneficial initiatives include measures to strengthen the role of regional development banks; foster the emergence of regional bond markets; reduce transaction costs for migrant remittances; and establish currency swap arrangements to reduce the need for reserve accumulation (UNCTAD, 2010, 2015d). Most African LDCs are involved in some form of initiative aimed at monetary and financial integration, in the context of regional trade agreements. These initiatives are currently at different stages of advancement, ranging from existing monetary unions (for example, the West African and Central African CFA zones, and the Common Monetary Area of the Southern African Customs Union) and planned monetary unions (for example, the West African Monetary Zone) to schemes for cooperation and convergence on monetary and financial issues (for example, in the Common Market for Eastern and Southern Africa and the East African Community) (UNECA, 2008).

E. International support measures

Graduation with momentum requires concrete ISMs providing support commensurate with LDCs' development needs.

As the discussion in chapter 3 of this Report highlights, there is unquestionably considerable scope to enhance the effectiveness of ISMs for LDCs. Sustainable development and graduation with momentum require the international community to move beyond symbolic acts, such as "best-endeavours" clauses and aid targets that remain unfulfilled for decades, to the establishment of specific and concrete measures providing tangible and predictable support that is appropriate to and commensurate with LDCs' development needs. There is thus a need for continued pressure on the international community to deliver such ISMs, as well as to fulfil their existing commitments and remove obstacles to LDCs' utilization of existing ISMs.

1. Development finance

The current development finance architecture is conducive neither to graduation with momentum nor to the achievement of the Sustainable Development Goals in the LDCs. ODA plays a critical role as the main source of external financing to LDCs, amounting to an average of $47 per person and

some 5 per cent of gross national income in 2014. Achieving the Goals and the objectives of the IPoA will require a major increase in ODA to LDCs, to meet the international target of 0.15–0.2 per cent of donor country gross national income. All donors should also fulfil their commitment (under paragraph 52 of the Addis Ababa Action Agenda) to allocate at least 50 per cent of their net ODA to LDCs. This is of particular importance to those countries expected to make up the LDC group in 2025 and beyond.

Donors should fulfil their ODA target commitments, and make aid more stable and predictable, and aligned with national development strategies.

Development partners should take account of the structural handicaps and vulnerabilities that characterize LDCs, and make aid more stable, more predictable and less procyclical (Guillaumont, 2015). The General Assembly (in resolution 67/221 (United Nations, 2013)) has also called upon development partners to consider the LDC criteria explicitly in their ODA allocations. In practice, however, donors have proved reluctant to link their aid in a consistent way to recipient countries' needs or levels of development (Alonso, 2015).

Graduation with momentum (and fulfilment of the Sustainable Development Goal and IPoA targets) also require improvements in development financing practices, to increase the effectiveness of ODA in promoting structural transformation and building resilience. A key aspect of this is closer alignment of ODA with recipients' national development strategies, in accordance with donor commitments under the Paris Declaration on Aid Effectiveness (OECD, 2005). As discussed in chapters 2 and 3, a key lesson of the graduation experiences of Botswana and Samoa was the importance of harnessing development finance to national goals.

Productive-capacity development should be as high a priority for ODA as social infrastructure and services.

Another important consideration is the sectoral allocation of ODA. Prior to the 2030 Agenda, influenced by the orientation of the Millennium Development Goals towards social goals, donors shifted ODA allocations towards social infrastructure and services, which accounted for 47 per cent of their total aid in 2014, compared with 30 per cent for productive-capacity-building, of which only one fifth was for agriculture. While ODA to social infrastructure and services is undoubtedly important, productive capacities require at least equal prominence, given the critical importance to all LDCs of removing constraints to productive investment, innovation and upgrading.

Policies to direct FDI towards development-oriented activities may usefully be adopted before graduation.

FDI flows to LDCs have increased over time, and now account for 3.5 per cent of their GDP. However, LDCs' capacity to attract private capital flows continues to be weakened by their structural conditions, including small domestic markets, limited financial sector development, weak regulation, limited human capital and inadequate infrastructure. Many LDCs have responded by seeking to attract FDI by offering foreign companies privileges and exemptions that are often not provided to domestic firms. However, as argued in *The Least Developed Countries Report 2010*, "the excessive focus on promoting FDI and neglect of domestic investment [is] … a biased and counterproductive approach", particularly in view the role of a vibrant domestic private sector in attracting sustained foreign capital flows (UNCTAD, 2010:167).

The more recent graduate countries (Cabo Verde, Maldives and Samoa) have succeeded in increasing FDI in the post-graduation period, mostly in the tertiary sector, average net inflows rising from 2.4 per cent of their GDP in 2000–2002 to 5.9 per cent in 2013–2015. However, such an increase cannot be relied upon in all graduating countries. It is also important to ensure that financing is oriented towards the specific needs of each LDC. Where there is the prospect of a post-graduation increase in FDI, governments should therefore introduce policies ahead of graduation to promote domestic investment in, and orient foreign investment towards, development-oriented activities rather than extractive industries.

Graduation with momentum requires the use of all appropriate financing sources, including borrowing (where this is possible within the limits of debt sustainability) as well as ODA and FDI. Combining financing from different sources can contribute to the advancement of wider development objectives (such as SME development, risk reduction, environmental benefits and improved access to financing opportunities), in addition to the direct benefits of individual investment projects.

Blended finance can offer opportunities, but needs to be treated with caution.

Blended finance — combining ODA and/or philanthropic funds with other private development finance — has been argued to offer an opportunity to leverage public resources to mobilize additional private finance for infrastructure and other investments, while underwriting risks and providing technical assistance and market incentives (AFD and UNDP, 2016). While large-scale projects can attract FDI, blended finance can also mobilize private domestic financing (for example, from pension funds and commercial banks), particularly for local development projects.[4] It also has the potential to leverage diaspora direct investment in projects with transformational impact (UNCTAD, 2012b).

However, while blended finance may thus have the potential to contribute to graduation with momentum, caution is warranted in its use, due to the complexity of the related financial instruments and the risk of creating contingent liabilities for the public sector. It is also important that the share and terms of the concessional element appropriately reflect the level of development and vulnerability of the recipient country. The use of blended finance should therefore be restricted to projects that would not be undertaken in the absence of such financing, and should prioritize projects with clear benefits for economic and social development (UNCTAD, 2015d: chap. VI).

Climate funds should conform to the principle of common but differentiated responsibilities.

Public participation in blended finance can also be used as an instrument of industrial policy, through use of the concessional element (typically funded by ODA) to orient investments towards activities with a potentially transformational impact (for example, in new sectors or in technological upgrading), or which promote inclusiveness (for example, through job creation, rural development, or economic empowerment of women or marginalized groups) or environmental sustainability. Blended finance projects may also contribute to institutional development, through technical assistance to local banks, pension funds, and national and local authorities for project financing, impact assessment and risk mitigation techniques, for example (UNDP and UNCDF, 2016).

Financial instruments such as GDP-indexed bonds, countercyclical loans and weather insurance may have some potential to reduce vulnerability and improve risk management — an issue of particular importance to the 40 LDCs that have relatively high economic vulnerability, as measured by the EVI. It may also be possible to build domestic resilience through appropriately designed insurance policies to offset the losses associated with underdeveloped infrastructure.

Technical assistance is needed to develop and secure adequate financing for green investment projects.

Despite their negligible historical contribution to climate change, it is LDCs that are most affected by its impacts. Various types of external financing, some of them LDC-specific, are available to help LDCs to strengthen their resilience to such impacts. Such funds should conform to the United Nations Framework Convention on Climate Change, in particular the principles of common but differentiated responsibility and respective capacities. Development partners should both increase technical assistance to LDCs to incorporate climate adaptation needs into their national development strategies, and ensure that the LDC Fund has adequate resources to finance these needs in full and in a timely manner.

Graduation from the LDC category must not prevent countries from accessing climate funds. Rather, graduating countries should retain access

commensurate with the needs and risks they face, in line with smooth transition practices. The Green Climate Fund, a stand-alone multilateral financing entity that aims to deliver equal amounts of funding for mitigation and adaptation, could be extremely beneficial to LDCs and graduating countries alike.

Technical assistance is also needed to enable LDCs and graduating countries to develop green investment projects and secure adequate financing for them, including through innovative financing mechanisms such as green and blue bonds, whose proceeds are tied to environmentally friendly investments. However, effective mobilization of all these financing mechanisms requires significant improvements in LDCs' managerial and institutional capacities.

The architecture of international finance for development has become increasingly complex and fragmented…

2. Proposal: An LDC finance facilitation mechanism

Chapter 3 highlighted the problems arising, not merely from the limited fulfilment of international commitments to financial ISMs, but also of the constraints LDCs face in securing access to those that are available. This applies both to LDC-specific ISMs and to those open to all developing countries, under which LDCs are in principle equally entitled to support.

A key issue is access to finance. Over recent decades, an increasingly complex architecture of international finance for development has evolved, encompassing an ever-growing multitude of separate but interrelated multilateral, regional, bilateral and public–private institutions and mechanisms, and separate funding windows within institutions. While the case of climate finance, highlighted in chapter 3, is particularly acute, the issues of fragmentation and complexity extend across the development finance architecture as a whole.

...giving rise to an unnecessary obstacle to funding and an excessive burden on LDCs' institutional capacities.

This has two consequences. First, while the 2030 Agenda emphasizes the holistic and interdependent nature of the various elements of sustainable development, funding is increasingly compartmentalized, potentially impeding financing for (and thus discouraging) investments based on cross-cutting or holistic approaches. Second, increasing fragmentation has given rise to multiple potential funding sources for projects within certain areas. This may be an obstacle to locating an appropriate funding source, as each agency has its own particular criteria and priorities, as well as its own (often complex) application and monitoring procedures. These two aspects give rise to an unnecessary obstacle to funding and an excessive burden on the institutional capacities of LDCs. There is also a risk that they will give rise to a corresponding fragmentation of investments in recipient countries at the expense of more systemic and holistic approaches, and that investment programmes will become driven by the priorities of funders rather than countries' own needs and priorities.

A considerable streamlining is needed and a finance facilitation mechanism for LDCs could address the issues more immediately.

These issues argue for a considerable streamlining of the development finance architecture across all sectors; for much faster progress towards the coordination and harmonization of donor requirements; and for greater efforts to ensure that such requirements take full account of the constraints facing recipient countries, particularly LDCs. However, the limited progress made towards fulfilment of commitments in these areas in the decade since the Paris Declaration (OECD, 2005) indicate the need for an alternative approach if this is not to be a serious obstacle to the achievement of the Sustainable Development Goals.

Specifically, the effectiveness of financial ISMs could be greatly enhanced by the establishment of an LDC finance facilitation mechanism (FFM) as a "one-stop shop" to identify potential funding sources for the investment projects contained in their national development plans across all areas of sustainable development, and to support funding applications from LDCs. By developing the necessary

knowledge of donor requirements, priorities and preferences, and monitoring the constantly evolving architecture of development finance, this could provide a valuable public good to LDCs. It could greatly enhance the efficiency of the process by which the investment needs identified by each country are matched with funders' priorities; reduce funding delays and uncertainties; lessen the administrative burden on LDCs associated with securing investment financing; and support the movement towards greater country ownership and more country-led development strategies, as envisaged in the Paris Declaration and the 2030 Agenda.

Achieving 100 per cent DFQF coverage for LDC exports would be an important step.

Appropriately designed and implemented, such a mechanism could also contribute to national capacity development through secondments and "shadowing" of FFM staff on country missions, as well as through capacity-building and training programmes. It could also play an important role as an advocate, both for improved delivery on financial commitments to financial ISMs, and for improved donor coordination and harmonization.

Adequate funding would be essential to the effectiveness of such a mechanism. While costs could be limited by locating it within an existing institution, the demands of matching the investment needs of 48 countries with the priorities of many hundreds of potential funding sources would be considerable; and with inadequate funding or staffing it could potentially become a bottleneck, which would obstruct the process as much as facilitating it. However, in light of the key role of LDCs in the achievement of the Sustainable Development Goals, and of development (and climate) finance in the attainment of the Goals in these countries, this might be expected to be a high priority for donors. In view of its long-standing work on financing for development and on LDCs, UNCTAD could play a useful role as a member of the board of the FFM, which would decide its priorities, policies and practices.

A key objective of smooth transition should be to maintain some degree of preferential market access in key export markets.

3. Trade[5]

Although not all countries have adopted preferential trade schemes for LDCs, and the coverage of existing duty-free quota-free (DFQF) arrangements remains incomplete, preferential market access stands out as one of the most effective ISMs in favour of LDCs. Achieving 100-per-cent DFQF coverage for all exports from all LDCs would thus represent an important step, both towards the Sustainable Development Goal target of doubling LDCs' share in global exports (target 17.11) (Bouët and Laborde, 2011; Nicita and Seiermann, 2016) and towards graduation with momentum. By the same token, the loss of preferential market access represents the most serious negative factor in the economic calculus of graduation, giving rise to potential annual losses of export revenues in excess of $4.2 billion across LDCs as a whole. The implications vary greatly across countries according to their respective trading patterns, export compositions and alternative trade arrangements (chapter 4). In some Asian LDCs in particular, there is a risk that the competitiveness of manufactured exports may be undermined. In a context of footloose foreign investment, and given outsourcing practices in buyer-driven value chains (notably in the apparel sector), this could trigger some relocation along global production networks, jeopardizing these countries' diversification efforts.

Successful smooth transition requires a proactive role of the graduating country and collaboration of development partners.

Thus, a key feature of a successful smooth transition strategy is to ensure that some degree of preferential access is retained in key export markets through other unilateral preference schemes (such as the Generalized System of Preferences), or through bilateral or regional agreements. This requires both a proactive role on the part of the graduating country and collaboration and flexibility on the part of its developed and developing trade partners, to prevent the disruption of trade relations along established value chains. The experience

of Cabo Verde is paradigmatic in this regard: shortly after losing its eligibility under the European Union's LDC-specific Everything But Arms initiative, the country successfully applied to its Generalized System of Preferences Plus scheme, hence retaining a significant preference margin relative to its non-LDC competitors (chapter 4).

Notwithstanding the tangible benefits of preferential market access, however, it is important not to overemphasize its strategic value. Preference erosion can be expected to continue as liberalization of trade continues, and may well accelerate with the conclusion of "mega-regional" trade agreements currently under discussion; and this will inevitably reduce the commercial value of preferential treatment for LDCs over time (UNECA, 2015a). To offset the effects of preference erosion, preference-granting partners could review their respective rules of origin, to bring them into line with the WTO Ministerial Decision on Preferential Rules of Origin for Least Developed Countries, originally adopted in 2013 in non-binding language and further elaborated two years later.

The strategic importance of preferential access should not be overemphasized given preference erosion and the growing relevance of NTMs.

The strategic value of preferential market access is further weakened by the growing relevance of trade-restrictive non-tariff measures (NTMs) relative to tariff barriers, which has been identified in a growing body of research (UNCTAD, 2013b).[6] This is particularly pertinent in the context of LDCs, many of which are specialized in products (notably agricultural goods) that are subject to numerous NTMs, and whose producers face particular difficulty and/or expense in complying with them (Nicita and Seiermann, 2016).

This highlights the importance of strengthening technical and financial assistance to LDCs on NTM-related issues in the context of the Aid-for-Trade initiative. Key elements of such assistance include:

Technical and financial assistance to LDCs on NTM-related issues should be strengthened.

- Strong and tangible support for the upgrading of hard and soft infrastructure in LDCs;
- Capacity-building for the private sector, particularly SMEs, on NTM compliance and related challenges;
- Capacity development and institution-building in the areas of quality assurance and standard-setting and -monitoring;
- Assistance for systematic data collection and dissemination on NTMs and their restrictiveness;
- Technical assistance for the implementation of the Trade Facilitation Agreement, to reduce trade-related costs (notably for SMEs), and exploit the flexibilities in part II of the Agreement to ensure that the sequencing of implementation measures supports each country's development objectives.

Ongoing efforts to streamline NTMs should also be maintained, and should aim to ensure convergence, to the extent possible, towards commonly accepted international standards so as to reduce compliance costs (UNCTAD, 2013b).

Trade facilitation reforms and customs cooperation should be leveraged to curb trade misinvoicing.

Trade facilitation is of particular importance because of the alarming prevalence of trade mis-invoicing practices in LDCs, and their serious impact on domestic resource mobilization. The considerable scale of illicit financial flows, in particular from African LDCs, highlights the need to strengthen the international cooperation framework between customs agencies, revenue authorities and other related agencies to tackle such practices (UNCTAD, 2016c; UNECA, 2015b). Realizing the potential to leverage the customs cooperation provisions of the Trade Facilitation Agreement to curb trade misinvoicing is thus a priority for LDCs, as well as strategic use of the flexibilities enshrined in part II of the Agreement to reduce administrative obstacles to trade and reduce the high trade-related costs faced by LDC producers.

Further progress is also needed towards operationalizing the so-called LDC services waiver, to enable LDCs to take greater advantage of the expansion of international trade in services (UNCTAD, 2015e). A number of LDCs, particularly small island developing states, could benefit significantly from increases in the number of preference-granting countries and of the commercial value of preferences under the waiver. This could contribute to reducing the chronic commodity dependence of many LDCs (although services trade can also be volatile). As technological change and the emergence of GVCs have blurred the distinction between goods and services, there may be particular merit in boosting high-value-added services that have strong complementarities with manufacturing, notably in areas such as finance and ICTs.

Further progress is needed towards operationalizing the LDC services waiver.

More generally, it is clear that LDCs stand to benefit from a reinforcement of the regime of special and differential treatment (SDT) granted to them in the WTO context, and efforts are needed to break the current stalemate on this issue. The Monitoring Mechanism adopted at the Ninth WTO Ministerial Conference could offer a useful means for LDCs (as well as ODCs) to advocate for a strengthening of SDT provisions. Efforts are also required to preserve the existing flexibilities to the extent possible. LDCs should carefully consider the strategic advantages and disadvantages of proposed "WTO-plus" arrangements in regional and bilateral trade arrangements, especially those among countries at largely different levels of development.

An emerging concern is the current lack of a systematic set of smooth transition procedures within the WTO legal framework to ensure that eligibility for SDT provisions is not lost abruptly on graduation. In the absence of such provisions, graduation requires simultaneous modifications to existing legislation across several areas to implement multiple WTO obligations from which LDCs, but not ODCs, are exempt. This demands considerable time and resources, and can give rise to significant uncertainty and disruption for producers and investors. Technical assistance to preparations for this transition phase may also be helpful, particularly to those graduating countries with limited institutional capacities.

The absence of a systematic set of smooth transition procedures in the WTO is an emerging concern.

4. Technology

Technology has, to a great extent, been the missing link of the ISM architecture for LDCs. Despite the key role of technological upgrading in structural transformation and the development of productive capacities, ISMs in this field have hitherto been very limited.

In principle, the establishment of the United Nations Technology Bank, with the stated objective of contributing to LDCs' efforts to build a solid and viable technological base, represents a first step towards filling this gap. However, its effective fulfilment of this role will depend, inter alia, on:

Technology has been the missing link of the ISM architecture.

- Implementation proceeding on the current schedule without further delay, particularly in light of the considerable lapse of time since the initial proposal of the Bank (2011);
- Establishment of a continuous monitoring mechanism to ensure that the Bank's stated objective is fulfilled;
- Adequate financing, especially as activities are expanded, to ensure that the Bank's effectiveness is not impaired by insufficient funding, as many other ISMs have been;

- Due consideration of the development level of each LDC in the provision of technical assistance to intellectual property management. Different levels of economic development require different systems of intellectual property, as they typically become more stringent at higher levels of development (Hoekman et al., 2005; Gehl Sampath and Roffe, 2014). Therefore it is important to avoid encouraging LDCs to adopt more strict intellectual property protection systems than are compatible with their development level.

The Technology Bank, once in operation, could be a first step towards filling the gap…

The Bank could play a particular role in the transfer of technologies not subject to intellectual property (for example, those generated by collaborative processes for incremental innovations based on free access such as open-source innovation) and those that are at the end of intellectual validity, which are often as relevant to LDC development as those subject to continuing intellectual property protection.

…but does not obviate the need for other technology-related ISMs, such as operationalizing article 66.2 of the TRIPS Agreement.

The establishment of the Technology Bank by no means obviates the need to implement other ISMs in the field of technology. In particular, the ISM foreseen in article 66.2 of the TRIPS Agreement could be advanced through implementation by the TRIPS Council of its own 2003 decision to review the system for monitoring developed countries' compliance with their obligations under this article. The Council could usefully require developed countries to adopt a standard format for reporting to provide comparable information on programmes and policies, on the basis of an agreed definition of technology transfer. Such reports could also provide information on the financing involved and, critically, on the impacts of the measures taken. LDCs could move beyond their current focus on TRIPS-Agreement implementation to report on the contribution of such technology transfer to the establishment of a sound and viable technological base, and/or submit needs assessments indicating priority areas and sectors for technology transfer (Foray, 2009; Moon, 2011). This would provide greater clarity to the processes and programmes by which developed countries provide incentives for the transfer of technologies that contribute to the building of technological capabilities in LDCs and thus to their long-term sustainable development.

Technology transfer could focus on technologies whose transfer is unprofitable, despite high social returns.

Technology-transfer activities by developed countries could usefully focus on technologies whose transfer is unprofitable to technology owners, due to high costs associated with a limited absorptive capacity in the receiving country, but has a high social return because the technologies correspond to local needs and contribute to technological upgrading and/or social development. In these circumstances, market incentives are insufficient to bring about technology transfer, and additional incentives are therefore required. Such technologies might include, for example, those needed for the production of drugs and vaccines for tropical diseases. A second area of focus is medium-level technologies oriented towards entrepreneurs serving local markets, which may better reflect the factor endowments characteristic of LDCs than more advanced and capital-intensive technologies, and be more readily absorbed (UNCTAD, 2014c; Foray, 2009).

Aid could support "one-stop" brokerage services for intellectual property.

Developed countries could also contribute to improving the effectiveness of technology transfer by funding agencies specialized in linking donor agencies, private firms holding particular technologies and entrepreneurs in LDCs, acting as "one-stop" brokerage services for buying and selling intellectual property. Such agencies would identify the technology needs of firms in LDCs, locate potential providers of these technologies, and act as intermediaries in the technology-transfer process, while addressing intellectual-property-related issues and acting to ensure the effectiveness of technology transfer in the recipient country (Foray, 2009).

F. Least developed country criteria

The political declaration of the Comprehensive High-level Midterm Review of the Implementation of the IPoA (United Nations, 2016a: para. 48) states that:

> We recognize the importance of the reviews by the Committee for Development Policy of the graduation criteria for the least developed countries. We recommend the reviews be comprehensive, taking into account all aspects of the evolving international development context, including relevant agendas.

The 2030 Agenda suggests a possible need for revision of the graduation criteria.

Given its broader scope compared to previous development frameworks, the 2030 Agenda would seem to suggest a possible need for revision of the criteria, particularly in light of the growing economic divergence between LDCs and ODCs (chapter 1). There is also a case for considering modifications to the criteria to take greater account of the considerable heterogeneity of the LDC group, not least with respect to their geographical vulnerabilities.

In the context of graduation with momentum, there may also be some potential to improve the ability of the graduation criteria to capture the extent to which LDCs have overcome the structural impediments to their development. The experiences of the countries that have already graduated or are expected to graduate in the coming years (chapter 2) highlight two particular issues: the potential for LDCs to graduate without having achieved substantial structural transformation; and the failure of any LDC graduate to date to achieve the graduation threshold for the EVI.

The role of structural transformation in the criteria could be improved and strengthened.

In addition to increasing the alignment of the LDC criteria with the 2030 Agenda and the Sustainable Development Goals, consideration could be given to incorporating the perspective of graduation with momentum, to embed graduation in a longer-term process of sustainable development. This could be done by improving the measurement of structural transformation in the criteria and increasing its weight. The share of agriculture, fisheries and forestry in GDP, used as a proxy for structural transformation within the EVI (see box figure 1.1 in chapter 1), is at best a partial and imperfect indicator in this context. On the one hand, agricultural upgrading increases the indicator (other things being equal) because it expands agricultural production, which goes against improvements in the EVI; but agricultural upgrading is a critical component of what *The Least Developed Countries Report 2015* calls "poverty-oriented structural transformation" in LDCs (UNCTAD, 2015a), a precondition of graduation with momentum. On the other hand, the expansion of low-value services in the informal sector reduces the agriculture indicator, but this type of growth of the services sector does not contribute to structural transformation. These considerations show the shortcomings of the component of the EVI under analysis. The component might therefore be replaced with a composite index more fully reflecting the extent of structural transformation, encompassing the structure and diversification of production, employment and trade; technological capabilities; labour productivity; urbanization; and demographic dynamics. It would also be possible to increase the weight of structural transformation in the EVI, by according a far greater weight to this composite indicator than that accorded to the agriculture index in the current criterion. One approach would be to off-set this by reducing the weights of geographical variables (size and remoteness), which are essentially static rather than dynamic, and thus change little over time.

The environmental aspect of the EVI could also be improved to reflect a broader range of issues.

Consideration could also be given to improving the environmental aspect of the EVI. The environmental subindex is currently limited to the share of

population in low-elevated coastal zones and victims of natural disasters (see box figure 1.1 in chapter 1). However, while the former is clearly of critical importance to some LDCs (notably Bangladesh, Kiribati and Tuvalu), it is not an effective indicator across all LDCs, particularly those that are landlocked, where it is zero. It might therefore be beneficial to extend the environmental subindex. Possible approaches would include adding components reflecting environmental issues of particular relevance to LDCs, such as the frequency of extreme weather events and/or the volatility of precipitation; or using existing environmental indices.[7]

A gender component could be added to the HAI.

Given the importance of gender inequality as an obstacle to structural transformation and development, there might also be a case for adding a gender component to the graduation criteria. A relatively straightforward approach would be to add a gender component to the HAI.[8]

Beyond possible modifications to the formulae used for the criteria, consideration could also be given to establishing a "vulnerability ceiling" — that is, a maximum level of the EVI that all countries would need to meet in order to graduate, in addition to satisfying the existing criteria.[9] It could be set at half the level of the graduation threshold. Given the key importance of reducing structural vulnerabilities to reach sustainable development beyond graduation, this might be seen as representing a maximum level of structural vulnerabilities compatible with graduation with momentum.

A "vulnerability ceiling" could be considered as a condition for graduation.

A more far-reaching proposal, in line with the concept of graduation with momentum, would be to separate the structural transformation and environmental dimensions and build separate indices. The structural transformation index could also be made a mandatory condition for graduation.

G. Summary

- There is a need to move from graduation strategies focused on meeting the statistical criteria for graduation to "graduation-plus" strategies that take a longer-term perspective and lay the foundations for subsequent development by building productive capacities and fostering structural transformation.
- Accelerated transformation of rural economies is essential, through coordinated measures to upgrade agriculture and promote non-farm activities, taking full advantage of the synergies between the two.
- Structural transformation requires proactive policy action encompassing a combination of cross-sectoral and sector-specific industrial policies.
- A considerable scaling up of public investment is required, especially in rural areas, including projects that strategically address bottlenecks in the productive sector. This requires increasing the available fiscal space by improving taxation and revenue collection systems, diversifying public revenue sources and addressing the challenge of illicit financial flows, which besets fuel- and mineral-exporting countries in particular.
- Addressing gender inequality as a cross-cutting issue across all policy areas is essential, to ensure that human resources are used more fully and more efficiently, and entrepreneurship and creativity are harnessed more effectively for development.
- A more stable and development-oriented international environment is conducive to graduation with momentum, as well as better and more effective ISMs. Key issues are reforms to reduce volatility in financial and commodity markets and to resolve debt crises effectively.

- Donors should meet their long-standing commitments both on the level of ODA to LDCs and on aid effectiveness, including by making aid more stable and predictable and aligning it with national development strategies to support the development of productive capacities.
- An LDC finance facilitation mechanism could increase and accelerate LDCs' access to official finance and reduce the burden on their limited institutional capacities – but adequate funding and staffing would be essential. UNCTAD could play a useful role as a member of its board.
- Fulfilment of the commitment to 100-per-cent DFQF market access for all exports from all LDCs would represent an important step; and trading partners should bring their rules of origin into line with the 2015 WTO Ministerial Decision on the issue.
- Efforts are needed to break the current stalemate on reinforcing the existing SDT regime in the WTO, since that would ensure that SDT measures become more meaningful and effective.
- Technology has been the missing link of the ISM architecture. Once operational, the Technology Bank should help to fill this gap; but other measures are also needed to promote technology transfer to LDCs and the strengthening of their technological capabilities.
- Consideration could be given to revising the graduation criteria to give greater weight to structural transformation; to improve their environmental dimension; to take account of gender inequality; and/or to impose a ceiling on the level of vulnerability at graduation.

Notes

1 The political declaration of the Comprehensive High-level Midterm Review of the Implementation of the IPoA states: "It is also important that graduation be seen not as a cut-off point, but as a resolute move towards better and sustained economic development and virtuous and inclusive sustainable development." (United Nations, 2016a: para. 46).

2 Various tools have been developed which could be used in this context, including growth diagnostics (Hausmann et al., 2008), industrial strategy design (UNCTAD and UNIDO, 2011), operationalizing the product space (Fortunato et al., 2015) and the Growth Identification and Facilitation Framework (Lin and Monga, 2010).

3 "Labour-based in relation to the production process and technologies used in the production of goods and materials and in Construction Works means methods of production and technologies that are designed and managed so as to promote the creation of employment with predetermined socio-economic benefits" (ILO, 2002: Glossary of terms).

4 In the case of the Local Finance Initiative of UNCDF (which finances transformative investment with impact on local communities) for example, the leverage ratio between the ODA (grant) element and domestic finance is 1 to 10 (UNDP and UNCDF, 2016).

5 The rise of global production networks has dramatically intensified the interconnection between international trade and investment flows. Thus, while the following discussion essentially takes an international trade perspective, reflecting the more tangible nature of ISMs in this area, much of it also pertains, mutatis mutandis, to international investment.

6 Despite the overall weakening of tariffs as trade barriers, their role is uneven across products and industries. Thus, tariff escalation in metal products still can act as a deterrent to export upgrading in LDCs, as seen in chapter 3.

7 Examples of environmental indices are the Environmental Performance Index (Hsu, 2016) and the Physical Vulnerability to Climate Change Index (Guillaumont and Simonet, 2011).

8 An indicator of the gender gap which can be used is the Gender Development Index calculated by the United Nations Development Programme as part of the Human Development Index.

9 It is important to recall that improvements in the vulnerability situation of a country are reflected in reductions of the EVI. This is the opposite of the other two LDC criteria (Income and HAI), where improvements are measured as increases in the indicators.

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The 2011 Istanbul Programme of Action (IPoA) set a target that at least half of the least developed countries (LDCs) should satisfy the criteria for graduation from the LDC category by 2020. At the midpoint between the adoption of this target and the target date, UNCTAD's *The Least Developed Countries Report 2016* evaluates the prospects for the fulfilment of this target, and reviews the significance, nature and process of graduation.

Graduation is the process through which a country ceases to be an LDC, having in principle overcome the structural handicaps that warrant special support from the international community, beyond that generally granted to other developing countries. However, the Report argues that it should be regarded, not as a winning post, but rather as a milestone in a country's long-term economic and social development. Thus, the focus should not be on graduation itself, but rather on "graduation with momentum", which will lay the foundations for long-term development and allow potential pitfalls to be avoided far beyond the country's exit from the LDC category. Structural transformation, the importance of which is explicitly recognized in the 2030 Agenda for Sustainable Development, plays a fundamental role in this process.

Projections conducted for the Report suggest that only ten of the 48 current LDCs are likely to fulfil the graduation criteria by 2020, well short of the IPoA target. Unless effective national and international action is taken, the ensuing graduations are also likely to widen the development gap between the remaining LDCs and other developing countries still further.

While there are numerous international support measures (ISMs) for LDCs, their contribution towards graduation is undermined to varying degrees by vague formulation, non-enforceability of commitments, insufficient funding, slow operationalization and exogenous developments in international trade and finance. Their effectiveness also depends critically on the institutional capacities of each LDC to leverage them in support of its own development agenda. Nonetheless, loss of access to LDC-specific trade preferences after graduation may entail substantial costs, estimated by the Report to be in the order of $4.2 billion per year across LDCs as a whole. Such losses underscore the importance of effective smooth transition procedures, and of strong leadership and sound preparation on the part of LDC governments.

The Report highlights the need for LDCs to move from graduation strategies focused on qualification for graduation to "graduation-plus" strategies that take a long-term perspective and foster structural transformation. Elements of such strategies include:

- Coordinated measures to upgrade agriculture and promote non-farm activities;
- A combination of cross-sectoral and sector-specific industrial policies;
- A considerable scaling up of public investment, especially in rural areas, to strategically address bottlenecks in the productive sector;
- Addressing gender inequality across all policy areas, to ensure fuller and more effective use of human resources.

Better and more effective ISMs are needed, as well as a more stable and development-oriented international environment.

FRONT COVER

The top picture signifies the importance of a forward-looking view of graduation, looking beyond qualification to the challenges that lie ahead. The remaining photos depict the transition of economic activities towards progressively higher levels of sophistication and diversification that underlies the development of productive capacities – starting from agriculture, through handicrafts and light manufacturing, to high-technology production.

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