

Chapter 2

Prospects of Graduation for Least Developed Countries: What Structural Change?

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2.1 Introduction

This chapter analyses the graduation trends and the prospects of graduation for the least developed countries (LDCs), updated before the Mid-Term Review of the Istanbul Programme of Action (IPoA). A major aim of the 2011 IPoA adopted at the Fourth UN Conference on the LDCs is ‘enabling half the number of least developed countries to meet the criteria for graduation by 2020’ (UN, 2011). Several official UN documents have referred to or reiterated this goal. Even though it was considered not fully realistic at the time of the Istanbul Conference, it is evidence of a change in international attitudes towards graduation. During the first decade of the millennium, fear of and resistance to graduation among some graduating countries dominated the picture. Since Istanbul, graduation has been considered less of a threat to the development of the graduating countries and more of a signal that these countries are reaching a new phase of development. Moreover, the General Assembly Resolution on Smooth Transition adopted in December 2012 (and following the Report of an Ad Hoc Working Group of the General Assembly on this topic) has dampened the fear of graduation: several measures are now implemented or considered to make the transition smoother, such as continuing to provide some trade capacity-building after graduation, through the so-called Enhanced Integrated Framework (EIF).

This chapter first updates our contribution to the previous LDC IV Report (Drabo and Guillaumont, 2014). It outlines the implications of the previous and revised graduation rules for the graduation prospects of LDCs and shows that, in spite of a small change brought to the rules in 2015, no more than one fifth of the Istanbul LDCs (instead of one half) are likely to meet the graduation criteria in 2020. Prospects after 2020 are more favourable, in particular if LDCs can achieve the high rates of economic growth that are another goal of the IPoA. The chapter also questions the consistency of the IPoA graduation goal with the graduation rules.

The chapter also raises the issue of the consistency between the process of graduation and the structural transformation of LDCs, the importance of which is underlined in the IPoA (for more details see Cariolle et al., 2015; Drabo and Guillaumont, 2016). By definition, graduation is expected to occur when a country has overcome the structural handicaps that make it difficult to move sustainably out of low-income status—that is, that make it an LDC. We here consider the structural change corresponding to the reduction of the structural handicaps to growth on which graduation relies—namely, the improvement of human capital and the reduction

of structural economic vulnerability. This structural change is conceptually distinct from structural transformation, understood as a reallocation of resources likely to make the economy more productive, but to a large extent it is needed for it. The policy instruments involved in achieving the structural changes leading to graduation could not be examined here.

2.2 Graduation constrained by the rules applied

The prospects of graduation depend on the rules and criteria applied. Since the origin of graduation, there has been an asymmetry between inclusion and graduation criteria, set up for precautionary reasons. To be included, a country should meet three complementary criteria: a low level of income per capita, a low level of human capital, assessed using the Human Assets Index (HAI), and a high level of structural economic vulnerability, assessed using the Economic Vulnerability Index (EVI). Three main precautions are taken before an LDC can be recommended for graduation: (i) not only one but two of the three criteria of inclusion should no longer be met; (ii) margins need to have been set up between inclusion and graduation thresholds for each criterion; and (iii) a country is recommended by the Committee for Development Policy (CDP) only after having been found eligible at two successive triennial reviews. Moreover, since 2004, a country is graduated only three years after endorsement by the General Assembly of the CDP recommendation. An exception to the initial ‘two criteria rule’ was introduced in 2005: a country can be found eligible for graduation if its per capita gross national income (GNIPc) is at least twice as high as the ordinary income graduation threshold and deemed sustainable, making income per capita the only one criterion for graduation in these cases (see more details in CDP and UNDESA, 2015—the CDP Handbook—and in Drabo and Guillaumont, 2014).

The impact of criteria asymmetry is high. At the 2015 review, among the 48 LDCs under consideration 31 were no longer meeting the three complementary inclusion criteria (at the 2012 review there were 26 out of 49 LDCs) (CDP, 2012, 2015; CDP and UNDESA, 2015). This means that, without the present asymmetry, the IPoA goal would have already been reached, even over-reached.

In order to examine graduation prospects, it should be supposed that the graduation criteria remain unchanged: either two inclusion criteria, adjusted by a given margin, need no longer be met (initial rule, but since 2015 with a new definition of thresholds, explained below) or only an income per capita criterion at a higher threshold should be reached (additional 2005 rule). Other results could be obtained using alternative rules.

Until 2015, there was an important difference between the EVI and HAI criteria, and the GNIPc criterion. The former were relative thresholds put in place according to the quartile value of a reference group, the number of which remains approximately the same; the latter was and still is an absolute threshold, unchanged in constant dollars. This difference had significant implications for eligibility. Since 2015, the HAI and EVI thresholds are also supposed to be absolute. In fact, they are maintained at a constant nominal value of the indices corresponding to the threshold level in 2012

(the date of the previous review of the list of LDCs by the CDP), instead of moving with the whole set of the reference group. This makes graduation easier, as shown below.

The graduation prospects are also constrained by the timeframe of the graduation process. In order to ‘meet the criteria by 2020’, a country should be found eligible at two successive triennial reviews, strictly speaking no later than at the 2015 and 2018 reviews! And a country meeting the criteria in 2018 cannot effectively be graduated before 2021 ...

2.3 No more than one fifth of LDCs likely to reach the one half IPoA goal

Three graduations occurred before IPoA—Botswana (1994), Cape Verde (1997) and Maldives (2011)—but only one country has graduated since 2011 (Samoa, 2014). For two other countries, graduation has already been decided (by the General Assembly), to be effective later: Equatorial Guinea (2017) and Vanuatu (2020). Three others, having twice been found eligible, have already met the criteria: Tuvalu (2012 and 2015, recommended for graduation by the CDP in 2012 but without endorsement by the Economic and Social Council (ECOSOC)), Angola and Kiribati in 2015 (Angola being recommended, Kiribati not). Five other countries were found eligible a first time in 2015, so they could be found so again in 2018 and ‘meet the criteria by 2020’, as set up in IPoA: Bhutan, Nepal, São Tomé and Príncipe, Solomon Islands and Timor-Leste. Thus, at the end of the decade, 10 out of the 48 LDCs of the IPoA could have met the graduation criteria, which means around one fifth instead of the IPoA goal of one half. Moreover, among the five countries found eligible a first time for graduation, three (Bhutan, Nepal, Solomon Islands) would not have been found so had the method used for determining the criteria thresholds not changed. Although graduation prospects are substantial, they significantly (and unavoidably) lag behind the IPoA goal.

As for the date of effective graduation, the result is of course even more modest. Out of the possible 10 countries that have met the graduation criteria, only four are likely to have graduated during the period covered by IPoA (Samoa, already graduated in 2014; Equatorial Guinea, expected in 2017; Vanuatu, 2020; Tuvalu, if ECOSOC, and then the General Assembly, endorse the CDP recommendation of 2012, before the end of 2017). The General Assembly decided in January 2016 on an exceptional additional postponement of two years for Angola, which means this country will not be graduated before 2021. That said, all or some among the six countries, including Angola, likely to have met the criteria no later than 2018 may also graduate in 2021.

Among the 10 countries having met or likely to meet the graduation criteria before the end of the decade, three have been found eligible according to the income-only criterion (Angola, Equatorial Guinea, Timor-Leste), and seven according to two criteria—GNIpc and HAI for most of them (Bhutan, Kiribati, São Tomé and Príncipe, Solomon Islands, Tuvalu, Vanuatu) and only one according to HAI and EVI (Nepal). Among the seven countries eligible with regard to two criteria, three actually

were also eligible according to the income-only criterion (Kiribati, Tuvalu, Vanuatu). Bhutan is likely to be so in 2018. This means six or seven out of 10 likely to meet the criteria before 2020 may have met the income-only criterion.

2.4 Better long-term prospects

In the longer term, several other LDCs could meet the income-only criterion if they achieve a significant and sustained rate of growth. Table 2.1 considers several options, starting from the income levels of 2014:

- With a rate of growth of GNIpc corresponding to the rate achieved from 2001 to 2014, 14 LDCs would meet the criterion in 2030.
- With the same rate increased by 1 per cent, 17 LDCs would fall into this category.
- With a rate of (total) income growth corresponding to the IPoA target of 7 per cent gross domestic product (GDP) growth, this number would rise to 18.
- If a rate of 7 per cent GDP per capita was achieved, 24 LDCs would meet the income-only criterion, corresponding to half the number of IPoA-eligible LDCs.

Before 2015, for reasons endogenous to the design of the criteria, the key driver of eligibility for graduation was likely to be growth of income per capita. Economic growth would progressively push LDCs to meet the income-only criterion, albeit slowly. Indeed, according to the pre-2015 method of determination of graduation thresholds, improvement on the HAI and EVI would have had little direct impact on graduation likelihood, as the HAI and EVI were considered relative criteria that could be met only through a change in the country situation with respect to a reference group. An improvement on the HAI and EVI was rather expected to have an impact on graduation as a factor of higher economic growth. However, with the 2015 method of determination of the EVI and HAI thresholds, left at their nominal value of 2012, some LDCs become more likely to meet the corresponding criteria. As noted above, in 2015, three countries were found eligible for graduation a first time, which would not have been the case (with the HAI) with the previous method (Bhutan, Nepal, Solomon Islands). In the next 15 years, the change in the determination of the graduation thresholds is likely to result in some LDCs meeting the graduation criteria more easily. This could soon be the case for Lao PDR, Lesotho and Yemen (HAI and GNIpc), Senegal (EVI and GNIpc) and Bangladesh and Myanmar (HAI and EVI). With this change, the IPoA goal for 2020 becomes realistic for 2030. At this time, if identification of LDCs remains what it is presently, the list of LDCs will include essentially African countries (and Haiti).

In its December 2012 Resolution on Follow-up to the Fourth UN Conference on the LDCs, the General Assembly rightly expressed ‘serious concern’ that, after a decade of steady growth, LDCs were facing significant challenges in sustaining their economic growth. Of course, growth in GNIpc may be influenced by exogenous factors other than the two structural features identifying LDCs (weak human capital and high economic vulnerability). Such factors have already been working during the past decade: the rise and decline of international prices of commodities, in particular

Table 2.1 Countries likely to meet the income-only graduation threshold at the next five reviews if they keep last decade growth rate of GNI or grow at the 7% target of IPoA

Review year	2018	2021	2024	2027	2030
List of countries likely to reach the income-only graduation threshold if their per capita growth rates remain those of 2001–2014	Angola Bhutan Equatorial Guinea Kiribati Timor-Leste Tuvalu Vanuatu (7 countries)	As previous column +1 Myanmar	As previous column +1 Lao PDR Sudan Zambia	As previous column +2 São Tomé and Príncipe Solomon Islands	As previous column +1 Cambodia
List of countries likely to reach the income-only graduation threshold if their economic growth rates increase by 1% compared with those of 2001–2014	As above (7 countries)	(8 countries) As above+1 Lao PDR	(11 countries) As above + 2 São Tomé and Príncipe Solomon Islands	(13 countries) As above+1 Djibouti	(14 countries) As above+3 Bangladesh Djibouti Lesotho
List of countries likely to reach the income-only graduation threshold if their economic growth rates are 7%	As above (7 countries)	(9 countries) As previous column +1 Solomon Islands	(13 countries) As previous column +1 Djibouti Lao PDR São Tomé and Príncipe Sudan Zambia	(14 countries) As previous column +2 Lesotho Myanmar	(17 countries) As previous column +3 Bangladesh Mauritania Yemen, Rep.
List of countries likely to reach the income-only graduation threshold if their per capita economic growth rates are 7%	As above (7 countries)	(8 countries) As previous column +6 Djibouti Lao PDR São Tomé and Príncipe Solomon Islands Sudan Zambia (13 countries)	(13 countries) As previous column +4 Lesotho Mauritania Myanmar Yemen, Rep.	(15 countries) As previous column +2 Bangladesh Senegal	(18 countries) As previous column +5 Benin Cambodia Chad South Sudan Tanzania (24 countries)

oil. Some other factors may appear in the next decade, in particular through new oil or mineral exports, as a result of recent discoveries. Another set of highly important factors relates to the improvement in domestic as well as international policies, in particular those recommended by IPoA. These are difficult to assess and predict, and this chapter does not consider them, except through simulation of the achievement of the 7 per cent IPoA target of economic growth. The rather limited prospects of graduation in the period covered by IPoA should be an incentive to implement and hopefully reinforce the support measures agreed on in Istanbul.

2.5 How fast has the change been in the structural features of graduating LDCs?

Prospects for graduation should be examined with respect to the rationale behind graduation, supposing that graduation rules are designed consistently. In principle, graduation corresponds to checking a country's capacity to sustain its development, as determined by the level and growth of its income per capita as well as by the reduction in its structural handicaps to growth. Supplementing the series already available of income per capita, retrospective series of the EVI and HAI set up at the Fondation pour les Études et Recherches sur le Développement International (Ferdinand) (Feindouno and Goujon, 2016a, 2016b) allow us to identify the countries that have achieved more promising results with respect to graduation. Here, we compare the evolution of the three key indicators of LDCs (GNIpc, HAI and EVI) in countries having graduated since Istanbul and graduating (Angola, Bhutan, Equatorial Guinea, Kiribati, Samoa, Solomon Islands, Tuvalu, Vanuatu) with their average level (i) for all LDCs and (ii) for other developing countries (details by country are available on the Ferdin website). Do graduated and graduating countries evidence a more rapid change than (i) other LDCs and (ii) other developing countries in the level of the three indicators supposed to represent their structural features and handicaps?

- The rate of growth of GNIpc, the initial level of which was higher than that of other LDCs, has been higher than in other LDCs, while being not higher than in other developing countries (Figure 2.1).
- The HAI, the initial level of which was significantly higher than in other LDCs, but lower than in other developing countries, has been increasing at a similar or slightly faster pace than in other LDCs, but significantly faster than in other developing countries¹ (Figure 2.2).
- The EVI, the initial level of which was significantly higher than in other LDCs, and even more than in other developing countries, has been decreasing relatively fast, faster than in other LDCs, and even more than in other developing countries, still staying at a higher level than in other LDCs (Figure 2.3).

These figures give a summary picture. They evidence that graduation has essentially been the result of economic growth and of improvement in the absolute level of human capital, measured by traditional indicators, and that it hardly corresponds to a reduction in structural economic vulnerability. This result remains consistent

Figure 2.1 Evolution of GNIpc in LDCs, other developing countries (ODCs) and recently graduated or on the track of graduation (RGTG) countries

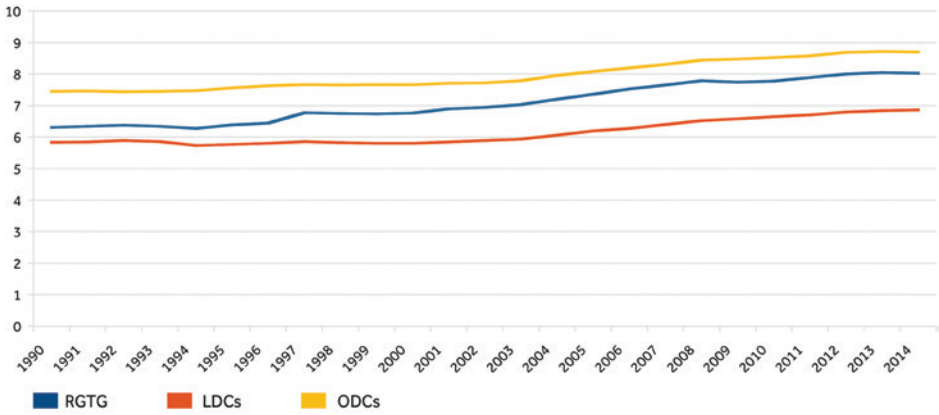


Figure 2.2 Evolution of HAI in LDCs, ODCs and RGTG countries

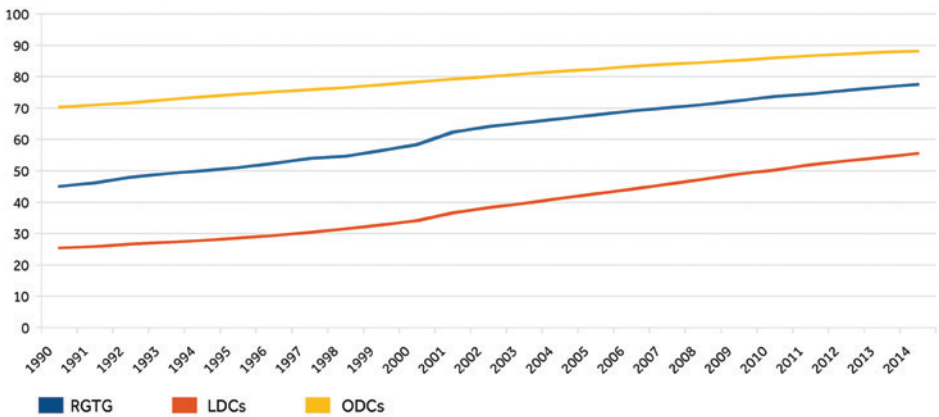
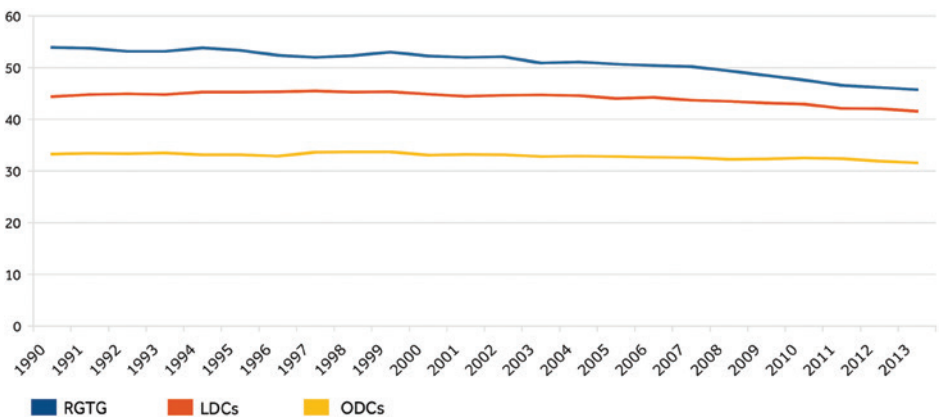


Figure 2.3 Evolution of EVI in LDCs, ODCs and RGTG countries



with the basic rationale of the category where the trap is supposed to correspond with both weak human capital and high structural economic vulnerability (the reason inclusion criteria are complementary), but it is not necessarily consistent with the IPoA goal of structural transformation. It is indeed so only if economic growth supported by a significant improvement in human capital is considered the basis of such a transformation and a sufficient condition to make development sustainable.

2.6 Making graduation rules more consistent with structural transformation

We have until now supposed the graduation rules roughly unchanged and have not considered any important change, except the recent change in the method of determination of the HAI and EVI thresholds. This change, avoiding the choice of a reference group of countries for the determination of the HAI and EVI criteria thresholds, has to some extent modified the nature of the LDCs, now considered poor countries facing an 'absolute' (but arbitrary) level of structural handicaps rather than relative structural handicaps. It has made eligible a first time for graduation three more countries that otherwise would not have reached the HAI graduation criterion.

Without changing the present rationale of graduation, other reforms could be considered. One could be the ranking of countries according to an 'expected natural income' determined using levels of income per capita, the HAI and the EVI. Easier to implement would be a revision in the measurement of the EVI (Guillaumont, 2014). A still easy to implement but deeper reform would be to follow a previous suggestion of the CDP (2005) to combine the two structural handicap indices in a synthetic index, used as an alternative criterion, which would have an impact on the path of graduation (Guillaumont, 2009a, 2009b, 2011). We explain elsewhere what could be the content and the use of a 'Structural Handicap Index' (SHI), combining the EVI and the (100-)HAI with limited substitutability. With such an index used as a graduation criterion, vulnerability would be necessarily taken into account as well as level of human capital, in a renewed rule of two criteria to be met (GNIpc and SHI), still supplemented by an income-only criterion at a higher threshold. Or it would be possible to combine in an aggregate measure the EVI, the (100-)HAI and income weakness in an index of 'least development', combining the three criteria. Actually, simulations of such changes do not lead to make the LDCs graduating the first strongly different from those identified from the present criteria. But they would make sure the graduation process takes into account the two kinds of structural handicaps presently considered for the identification of LDCs. It would then be that graduation corresponds to a 'structural change'.²

Of course, reduction in structural handicaps to growth, inherent in the goal of graduation, is not the same as 'structural transformation', also recommended by IPoA. Structural transformation, understood as a reallocation of resources likely to increase productivity, may be achieved in several ways, not the same in all countries. In any case, it does need a reduction in the structural handicaps to growth.

2.7 Concluding remarks

The argument of this chapter can be summarised as follows:

- Since Istanbul, graduation has been considered less of a threat to the development of graduating countries and more of a signal that these countries are reaching a new phase of development.
- The impact of asymmetry between inclusion and graduation criteria is high: At the 2015 review of the list of LDCs, among the 48 LDCs under consideration 31 were no longer meeting the three complementary inclusion criteria.
- In 2020, 10 out of the 48 LDCs of IPoA could have met the graduation criteria, instead of half set as a goal in the IPoA.
- The change brought in 2015 in the calculation of the thresholds of the two structural handicap criteria (EVI and HAI), making them absolute instead of relative criteria, has made easier to meet the graduation criteria, with three more countries found eligible a first time in 2015.
- Out of the 10 countries that will have possibly met the graduation criteria by 2020, only four are likely to have actually graduated during the period covered by IPoA.
- Six or seven out of 10 countries likely to have met the criteria by 2020 may meet the income-only criterion.
- Long-term prospects are better, in particular if LDCs are able to grow at the IPoA total income target of 7 per cent.
- But only with a 7 per cent rate of growth of income per capita, half of the 48 Istanbul LDCs will be able to have reached the income-only per capita criterion by 2030.
- Graduated and graduating LDCs have achieved this as a result of their economic growth and improvements in their levels of human capital. Their structural economic vulnerability, remaining high, had nearly no impact on graduation, although it has declined faster than has been the case in other LDCs.
- Reduction in structural handicaps—the rationale behind LDC graduation—could be better reflected in the design of the graduation criteria.
- Reduction in structural handicaps to development is also a condition of the structural transformation recommended by IPoA.

Notes

- 1 To some extent as the result of an upper bound to the index.
- 2 An even deeper reform would be to take into account not only handicaps captured through the EVI and the HAI but also vulnerability to climate change, through an appropriate index such as the Physical Vulnerability to Climate Change Index (PVCCI), set up at Ferdi.

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