

Statement by Professor Jose Antonio Alonso delivered on the occasion of the Second Substantive meeting of the Ad Hoc Working Group of the United Nations General Assembly on Strengthening Smooth Transition Provisions

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Distinguished chair persons,

Ladies and gentlemen,

I appreciate this opportunity to share with all of you some ideas about the situation of the Least Development Countries (LDCs) and about the process of transition that was designed for those LDCs that are going to leave the group.

Let me begin with a general and well-known idea: the LDC group is defined as a club of countries that deserved special international attention and support as a consequence of their structural handicaps. It was thought that these handicaps could block the normal process of development, so some specific support was necessary to help countries to overcome these obstacles. The group is defined as a club with clear rules of inclusion and graduation; and membership in the club is associated to some specific benefits mainly in the fields of trade, aid and other support measures. After more than forty years and four international conferences, it is reasonable to ask whether this answer (the category and the benefits associated to it) has been effective.

The data do not give us space for complacency. It should be said that we do not have a precise evaluation about the net effect of the LDCs measures. For doing that, we should build a counterfactual in which we could determine what would have happened if the LDCs mechanisms had not existed. Without that information, data provide only an imperfect approach. In any case, data of long-run growth reveal that the LDCs, as a group, have had a worse outcome than the world average. In other words, there has been a process of divergence between LDCs and the rest of the world, even in relation to the rest of developing countries. Looking at the graph on the screen, when we compare the level of GDP per capita in 1950 to 2006, most of the LDC countries are below of the diagonal line: that is, they grew less than the world average (graph 1). Moreover, the data reveal that a certain convergence did indeed occur within the group (those countries that started with lower GDP per capita tended to grow faster) (graph 2). This suggests that the LDCs have behaved as countries caught in a poverty trap (as far as levels of development are concerned, they are more similar among themselves than before, but the gap between them and the rest is wider). In other words, they have been incapable to follow the rate of the growth of the rest of the world.

And this conclusion remains valid even if we refer to the last decade of growth, before the current crisis, between 2000 and 2008. As the rest of the world economy LDCs had a decade of growth: per capita income rose on average by an unprecedented 4%, but income per capita in the rest of developing world rose even faster, by over 5%. Similarly, for example, infant mortality dropped by around 11% in LDCs, but in the rest of developing countries this rate

dropped by an impressive 18%. And if we consider other indicators, we will confirm that while LDCs advanced in absolute terms, they did not succeed in closing the gap with the other developing countries.

There is also some good news. Two should be underlined:

- Firstly, when the group was created LDC was defined as a group of low-income countries suffering from most severe structural impediments to sustainable development. So, the LDCs were a sub-group within the low-income countries. In fact, the group of LDCs was made up of around 40 countries, while there were more than 60 countries in the low-income group. Currently, the LDC group has 48 countries, but the low-income group has only 35 countries. The LDC group is larger than the low-income group. In other words, some of LDC countries belong now to the middle-income group, according to the World Bank classification. This is good news, because it confirms that some LDCs have had significant increase in their income per capita in the last decade.
- Secondly, and related to that, some LDCs were able to promote not only a sustained path of growth, but also a visible improvement in their Human Asset Index and in some cases (but not in all of them) in their Economic Vulnerability Index. So those countries will be meeting eligibility to graduate and therefore to move out of the category

Thus, it is important that transition from the LDC category should allow for further progress in the development process and avoid that previous achievements are jeopardized.

It is not easy to design a good transition process, mainly because – as I said before - the category was conceived like a club (only some countries belong to the club: if one country is part of the group it can access its exclusive benefits, otherwise it cannot do it). Therefore most of measures of support follow a binary logic. This logic is not appropriated at least for three reasons:

- i) Firstly, it is not adapted to the process of development: the process of development is continuous (not discontinuous). So the measures of support should be gradually adapted to the country's needs as long as the process of development evolves. Not in a binary logic, but in a gradual logic.
- ii) Secondly, it generates perverse incentives in terms of development, because to a certain extent, it may penalize progress. The measures of support are only available if the country fails in its process of development, but they disappear if the country is able to obtain some success.
- iii) And finally, binary logic implies that graduation is an apparently abrupt change in the country status. The possibility of losing access to the support measures causes concern among the countries meeting the criteria of graduation. Particularly those that consider that have important structural handicaps that can be not addressed by the international community outside the LDC group.

So a decision that should be celebrated (graduation means that the country has achieved higher level of development) is finally felt as a threat, as a consequence of this binary logic underlining the support measures.

It is important to say that this perception of risk, in some cases, is overstated. For two reasons: i) firstly, because most of countries have not taken advantages of all the benefits associated with the LDCs category (so they cannot lose what they did not use before); and ii) secondly, because some of the measures of support that they do use are not necessarily associated with LDC status (or at least, not in an irrefutable way).

In any case, the transition process should facilitate countries to have an accurate assessment (not overstated) of the effects of the graduation and break away with the binary logic that is in the base of LDC-specific measures by introducing gradual support that can be adapted to the progress of the country. And, at the same time, the international community should review the support measures for countries (belonging to the LDC group or not) that suffer from severe structural handicaps in order to offer suitable assistance for the solution of their problems (this is the case for example of “small islands”).

One of the CDP responsibilities is to analyze the conditions of graduation of LDCs. So we have studied this topic very carefully. We realized that there could be problems in three main areas: i) the procedures adopted to assist countries in preparing and implementing the transition strategy; ii) the phasing-out of LDC-specific measures; and iii) the situation after the graduation.

In the first area, preparations for the transition strategy, our main proposals are:

- i) increasing information about international measures, their utilization and related transition measures based on the DESA Information Portal;
- ii) supporting countries (through the UN system) in their preparations of transition strategies, that should be integrated in their national development strategies;
- iii) assuring that all development partners mainstream the smooth transition needs in their approaches and strategies; and
- iv) monitoring the process of graduating countries to avoid setbacks.

These suggestions aim at:

- First, improving the information about the process, so that the graduating country can make a more precise assessment of the effects of the graduation, in terms of the benefits and costs for its development.
- Second, a tighter monitoring of the country, in order to quickly identify problems or regressions.
- Third, calling for more explicit commitment by all donors and international institutions in support of the country.

In the second area, the phasing out of LDC-specific measures, our main recommendations are related to:

- i) extension of preferential market access for an adequate period to enable graduated countries to adjust to the new conditions;
- ii) phasing out LDC-specific provisions in the Special and Differential Treatment in the WTO;
- iii) avoiding abrupt reductions in official development aid provided to graduated countries, both from bilateral donors and from multilateral institutions;
- iv) maintaining other support measures such as the cap on LDC contributions to the budget of certain multilateral institutions and the financial support for LDC participation at certain meetings and conferences.

The purpose of these proposals is to extend some support measures in order to reduce the risks of the transition process and to introduce a criterion of gradual support instead of the binary logic. Finally, we think that it is important to address that particular situation of graduated countries that have special levels of vulnerability, even if they meet the criteria of graduation. This is an important issue, because, in part, countries' concern about being graduated is related to the perception that international support outside the LDC category is insufficient or inappropriate for meeting their needs. In this case, the problem is not the transition process, but the situation after the transition.

If we want to facilitate the transition process, we should define a more clear future, in terms of international support, for graduating countries with extreme vulnerabilities.

Well, in this case, we at the CDP think that three measures could be considered:

First, the introduction of some criteria related to the countries' vulnerability in the process of aid allocation by bilateral and multilateral donors. Vulnerability is related to factors of risk that are beyond the country's control. So in this case there are not perverse incentives as it may be the case in other criteria for aid allocation. The Economic Vulnerability Index is one of the three criteria that define the LDC category. So we recommend that donors in their aid allocation criteria also use the Economic Vulnerability Index. The purpose should be to reduce aid in a gradual and predictable way as the country's vulnerability index improves.

Second, we put forward 2 recommendations related to lack of diversification in the graduated country productive structure (one of the components of EVI):

- Extending the program of Aid for Trade in order to promote trade capacities in these countries in a more active way. This Initiative in its origin was oriented to LDCs, and focused on export activities. But now the scope of AFT activities has expanded considerably and now, besides trade-related assistance through technical assistance, it supports the building of supply-side capacities through private sector and trade-related infrastructure. And these activities are crucial for promoting export diversification. Total commitments from bilateral and multilateral donors in this Initiative reached close to US\$ 30 billion, with an additional US\$ 35 billion in non-concessional trade-relating financing. This initiative could be very useful for promoting diversification in graduated countries.

- The other measure is related to financial cooperation. Donors have created specialized institutions (the Development Finance Institutions, DFI) to manage instruments, that include equity investment (directly or through investment funds), loans and guarantees. In 2010 15 European DFIs managed a global portfolio of four thousand projects and facilitated US\$21.7 billion of investments across low and lower-middle income countries. It is estimated that around US\$ 5 billion of new funding, almost 6% of total ODA, are available for new projects every year. 55% of these funds was invested in equity (or quasi equity), 44% in loans and 2% in guarantees. Some 28% of these funds were oriented to Africa. We have to remember that most of LDCs are non-investment grade countries or countries that are excluded from private capital markets, so this mechanism could be very useful in increasing investment in infrastructures and in supporting the private sector.

Third, and finally, to further relieve the concerns of graduating LDC and to address their high vulnerability, insurance mechanisms against natural disasters or other adverse and unforeseen external shocks leading to a significant loss of income in graduated countries could be established and facilitated by development partners through aid or international taxation systems.

These are some of the ideas that we have considered in the CDP. Of course, we have to think more about these problems. Particularly, we have to think about how to address economic and environmental vulnerability. This is a problem that affects a lot of LDC countries and it is insufficiently and inadequately considered by the international community.

Thank you!