Impacts of Graduation from Least Developed Countries

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Introduction

On 20 December 2004, the Maldives was officially removed from the list of Least Developed Countries (LDCs). In order to guard against economic dislocation as a result of the move from LDC to Middle-Income status, the Maldives was granted a three year pre-graduation transition period during which countries can negotiate with development partners on modalities for a "smooth transition" (i.e. how to gently phase-out LDC benefits).

However, less than a week later, on 26 December, the Tsunami struck, causing economic damage and losses equivalent to around two thirds of the country's Gross Domestic Product (GDP) and destroying key infrastructure. As a result of the nationwide damage caused by the Tsunami, the United Nations General Assembly granted an exceptional three-year moratorium to the Maldives in 2005 to provide breathing space for post-disaster recovery and reconstruction. The moratorium ended in 2007 meaning the Maldives has now belatedly entered the transition period (which will come to an end in December 2010).

Upon full graduation from 2011 onwards, the Maldives will face a range of new challenges related to the removal of trade and development preferences. It is vital, therefore, that the country, and its international partners, work together to design and implement an effective transition strategy.

LDC Status

The establishment of a category of least developed countries (LDCs) was first advocated in the 1960s to attract special support measures for the most disadvantaged economies. From the outset, LDCs were recognized as the most vulnerable members of the international community, that is to say, low-income countries which faced severe structural handicaps to growth. Indicators of such impediments are the high vulnerability of the countries' economies and their low level of human capital.

The Committee for Development Planning (CDP)[1] proposed an initial list of 25 LDCs based on a simple set of criteria (per capita gross domestic product (GDP), share of manufacturing in GDP and adult literacy). The list, which included the Maldives, was approved by the Economic and Social Council and formally endorsed by the General Assembly in November 1971.

Since its creation, the CDP has gradually evolved the eligibility criteria for LDCs, in order to better reveal long-term structural weaknesses. The current criteria are based on:

- Gross National Income (GNI) per capita
- A Human Assets Index (HAI)
- An Economic Vulnerability Index (EVI).

In addition, in 1991, the CDP determined that countries with a population exceeding 75 million should not be considered for inclusion in the list of LDCs.

Graduation

The CDP undertakes, once every three years, a review of the list of LDCs (based on threshold levels for each of the three criteria), on the basis of which it advises the Economic and Social Council with regard to countries to be added to, or removed from, the list of LDCs.

In order to be considered for graduation, a country must cease to meet two of the three inclusion criteria. This has to be confirmed by the CDP over two consecutive triennial reviews. In between the two reviews, the UN Department of Economic and Social Affairs

[1] The Committee for Development Planning was established by Economic and Social Council resolution 1079 (XXXIX) of 28 July 1965 as a subsidiary body of the Council. Its original terms of reference were modified on 31 July 1998 pursuant to annex I of Council resolution 1998/46, and the Committee was renamed the Committee for Development Policy (CDP). Currently, the Committee provides inputs and independent advice to the Council on emerging cross-sectoral development issues and on international cooperation for development, focusing on medium- and long-term aspects. The Committee is also responsible for undertaking, once every three years, a review of the list of the least developed countries (LDCs), on the basis of which it advises the Council regarding countries which should be added to the list and those that could be graduated from it.

(DESA) prepares an *ex ante* impact assessment of the likely consequences of graduation for the country's economic growth and development, while the United Nations Conference on Trade and Development (UNCTAD), is required to prepare a vulnerability profile for the graduating country. The vulnerability profile aims to give an overall background of the economic and development situation and covers other vulnerability concerns not covered by the EVI (such as concentration of exports, high transportation costs due to geographic dispersion, impacts of climate change). Countries selected for graduation are provided with the vulnerability profile and impact assessment one year prior to their second review by the CDP - during which graduation is either confirmed or reversed.

Once graduation is endorsed by ECOSOC, based on the recommendation of the CDP following two consecutive reviews; the country is accorded a three year transition period during which it prepares a transition strategy in conjunction with development partners. This strategy is then implemented in the post-transition period.

In 2004, ECOSOC endorsed the CDP's decision to graduate the Maldives (along with Cape Verde). The CDP identified the Maldives as a candidate for graduation during two reviews – in 1997 and 2003 – based on the fact that it met the GNI per capita threshold and the Human Assets Index threshold (the country did not meet the EVI threshold). As already noted, graduation would normally have become effective in December 2007. However, taking note of the destruction wrought by the Tsunami of December 2004, the General Assembly decided, in November 2005, to defer the country's graduation for three years. The Maldives will thus now fully graduate as of 1 January 2011.

Throughout discussions on the country's graduation in both the CDP and the ECOSOC, the Maldives consistently argued that the criteria used by the UN are fundamentally flawed in that they pay insignificant attention to the inherent and extreme vulnerability of Small Island States. While one of the three criteria used by the CDP is an economic vulnerability assessment, this assessment ignores key vulnerability considerations for Small Island States such as environmental vulnerability, import dependency (for essential commodities), and geographic dispersion and isolation. Moreover, even if the economic vulnerability assessment does suggest that a Small Island State should remain in the LDC group; this is overridden if the other two graduation criteria (GNI and HAI) are met. Again this means that the particular needs and risks faced by Small Island States are essentially ignored.

Key areas of impact from graduation

As an LDC, the Maldives currently benefits from a range of special support measures from bilateral donors and multilateral organizations, and special treatment under regional and multilateral trade agreements. LDC benefits that will be lost or reduced as of 1 January 2011 include: trade preferences; official development assistance (ODA) including development financing and technical cooperation, and other forms of assistance.

International Trade

International trade, especially in tourism services and fisheries (which together account for 60-70% of GDP), is the most important area that could be impacted by graduation. There is particular concern about fishery exports (especially tuna) which, despite efforts to diversify the economic base, are still vital for the economy and for livelihoods.

Approximately 30% of Maldives tuna exports go to the EU. The Maldives is currently exempt from the 24.3% import duty levied on canned and fresh fish by the EU under the LDC-specific "Everything but Arms" (EBA) initiative (duty-free, tariff-free access). The loss of EBA preferences would be a major blow to Maldivian fish exports which would be put at a significant competitive disadvantage not only to more competitive 'most favoured nation' (MFN) exporters, but also to LDCs such as the Solomon Islands and non-LDC African Caribbean Pacific (ACP) countries such as Papua New Guinea and Fiji.

In a recent report following its mission to the Maldives (14-18 December 2008), the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), noted that graduation should technically also bring an end to market access preferences under the South Asian Association for Regional Cooperation (SAARC). This includes Preferential Trading Arrangements (SAPTA) for dried fish exports to Sri Lanka. Graduation would likewise result in the loss of preferential access to the Japanese tuna market (instead of a zero tariff, a 3.5% MFN rate will be imposed).

ESCAP also notes that graduation will affect the special treatment currently enjoyed by the Maldives under multilateral trading agreements (WTO). Normally, when the Maldives ceases to be an LDC, it would technically no longer benefit from existing special and differential treatment (although it could argue that as it started the Doha Round as a LDC it should benefit from Doha Round LDC preferences when an agreement is reached). There would also be implications for the Enhanced Integrated Framework (EIF) for trade-related technical assistance (this is for LDCs) – a framework currently being actively used by the Maldives.

Development financing

Especially at a time of global downturn and reduced aid flows, loss of LDC status is likely to be used as a reason, by development partners, to reduce concessionary treatment in bilateral allocations with a lesser grant element and a possible fall in overall allocations. However, as many development financing schemes do not explicitly refer to LDC status, it is difficult to know the exact impact of graduation on ODA.

Other forms of assistance

After graduation, the Maldives is likely to incur additional costs to travel to United Nations and WTO meetings, and will also have to make greater contributions to the UN Regular budget and to UN peacekeeping operations.

Maldives Government response

The Maldives Government fully understands the importance of ensuring a smooth transition from LDC status. While the Maldives has regularly argued against the current UN criteria for establishing graduation thresholds which pay insufficient attention to vulnerability factors, the Government understands that 2011 is now approaching fast and that it is vital for an effective transition strategy be put in place.

With this in mind, the Government is in the process of establishing an inter-ministry "Working Group on Smooth Transition from LDC Status". Terms of reference for this working group have been formulated and the main task of the Group would be to prepare a transition strategy in partnership with international partners such as UNCTAD and ESCAP.

On the basis of that strategy and using a newly established consultative mechanism, the Government will hold detailed discussions with trade and development partners to agree on the various elements that are vital to ensuring a smooth transition (e.g. maintenance, where possible, of important preferences; and, at the least, a clearly scheduled gradual removal where full retention is not possible).

However, ahead of these medium-term steps, the Government believes that it is important to sensitize trade and development partners, to begin a dialogue to understand their position, and to exchange ideas as to how the transition can be successfully managed. The Government holds that the Maldives Partnership Forum (MPF) offers an excellent opportunity to begin this dialogue.

This is important for the Maldives, as well as for LDC graduation in general, as the Maldives is one of the first to experience the process. Thus, the Maldives will "set the tone" for other planned graduations. Finally, it is vital to consider the wider context in which graduation is occurring –namely the birth of democracy in the Maldives. It would be a tragedy for democracy to become associated, in the minds of the population, with the onset of economic dislocation.

Possible questions and discussion points for the MPF:

- In the specific case of the Maldives, what are the likely broad parameters for a "smooth transition"? How can the international community ensure that the Maldives' positive development trajectory is not damaged? Will this require retention of benefits after 2011 in order to provide space for adjustment? For how long? Which benefits must be retained?
- The Government is grateful to the EU for agreeing to extend EBA tariff concessions on Maldivian fish imports until the start of 2014. However, longer term, the Government would like to explore the possibility of negotiating an economic partnership agreement with the EU. This would allow the Maldives to receive equal treatment with similar (e.g. Pacific island) countries that receive ACP benefits. Is this feasible?
- The Government is also working hard to comply with the eligibility criteria for the EU's GSP+ system for vulnerable economies. The Maldives has already acceded to many of the requisite international conventions. What more needs to be done?
- Will other key developed country trading partners such as Japan consider extending LDC preferences beyond 2011, in tandem with the EU?
- Can the Maldives retain preferences under the SAPTA?
- What about other South-South trade, for example with Thailand? Can this be improved through, for example, a reduction in MFN tariff rates for fish?

- How can the Maldives ensure that it continues to enjoy LDC special and differential treatment at the WTO, especially in the context of any final agreement under the Doha Development Agenda? How can the Maldives become more engaged and secure better benefits under the Small and Vulnerable Economy (SVE) negotiations at the WTO? How can the Maldives maximize benefits from the WTO Aid for Trade scheme?
- What steps, beyond existing work under the EIF, should the Maldives be taking to boost institutional capacity for trade policy development?
- What steps does the Maldives need to take to protect and further encourage development financing in the post-LDC period?
- Will the planned Foreign Investment Law and the planned establishment of Free Economic Zones help with the smooth transition?
- Will the UN agree to maintain travel benefits to and from international meetings? Under what conditions?