# Graduating from Least Developed Country to Middle Income Country Status: A Trap for Small Island Developing States?

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A dissertation presented to the Faculty of Arts in the University of Malta for the degree of Master in Contemporary Diplomacy

June 2014

## Declaration

I hereby declare that this dissertation is my own original work

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30 June 2014

Beijing, People's Republic of China

# Acknowledgements

I would like to acknowledge the unwavering support from my dearest wife-Sylvie, who has been my rock, my pillar and my best friend throughout this challenging process.

My gratitude also extends to my mother- Johnise, and mother in-law Thérèse for their constant encouragement to further my studies and also their financial support throughout this process.

I have to also express my appreciation to my colleague Rachel, who has so generously assisted with work tasks to ensure that I have sufficient time to complete the paper.

Special thanks to my supervisor, Ambassador Victor Camilleri for his guidance and wise advice which has definitely enriched my paper.

Finally, my gratitude to Patrick Borg for your constant support and for always being an email away from offering a solution.

# Abstract

SIDS tends to perform particularly well with regards to their socio-economic achievements and development endeavours. As a result, several SIDS graduate from their Least Development Country status to Middle-Income Country status. This graduation implies that SIDS are much better-off economically and can do without the special treatments and benefits in terms of Overseas Development Assistance that they were receiving as an LDC. However, and this is the thrust of the argument in this paper, this is not the case at all. The support was and is crucial to SIDS. After all, it was the catalyst which helped them progress and graduate in the first place. Without the financial assistance, post-graduation, many SIDS struggle to sustain these achievements. Essentially, finding themselves trapped.

Additionally, this research examines the inherent vulnerabilities of SIDS; particularly, their economic and environmental vulnerabilities, caused by their small size, small population, dependence on trade etc…

This research looks at two theories which could apply to SIDS once they have graduated to MIC status, to sustain the socio-economic progress made: The Export Diversification Model and the Development Aid Theory. In practical terms, the research leans towards the application of the Development Aid theory.

This paper studies the various classification models designed by the UN; - LDCs, MIC, SIDS, LLDC, LICUS; the graduation model the UN applies for the graduation and highlights some weaknesses with the model, and also discusses the graduation

process. This dissertation also focuses on some weaknesses which SIDS needs to address moving forward, for example, the limited definition of SIDS itself.

The role of foreign aid and a case study on the graduation experience of the Maldives Islands is highlighted and finally this paper concludes that SIDS do find themselves worse-off when they graduate because they do not receive the benefits they were previously obtaining as an LDC. To close, this paper proposes some recommendations.

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## List of Abbreviations and Acronyms

ACP- Africa, Caribbean and Pacific Countries
AGOA -African Growth and Opportunity Act (USA)
AIMS- Islands of the Atlantic Ocean, Indian Ocean, Mediterranean and South China Sea
AOSIS -Alliance of Small Island States
ASYCUDA-Automated System for Customs Data
BPOA- Barbados Program of Action
CARICOM- Caribbean Community
CDP- United Nations Committee for Development Policy
CMMS- Comoros, Mauritius, Madagascar, and Seychelles
EBA -Everything but Arms Initiative (EU)
EC- European Commission
ECOSOC -United Nations Economic and Social Council
EDI- Economic Diversification Index
EEZ -Exclusive Economic Zone
EIF-Enhanced Integrated Framework (for Trade-Related Assistance for the Least Developed Countries)
EVI -Economic Vulnerability Index
EU-European Union
FDI -Foreign Direct Investment
FOCAC- Forum on China–Africa Cooperation
GDP- Gross Domestic Product
GNI- Gross National Income
HAI- Human Asset Index
HDI- Human Development Index
ICT- Information and Communication Technologies
IDA- International Development Association (World Bank)
IMF- International Monetary Fund
IOC-Indian Ocean Commission
LDC -Least Developed Country
LICUS- Low Income Countries Under Stress
LLDC -Landlocked Developing Countries
MDGs -Millennium Development Goals
MIC- Middle Income Countries
MFA-Ministry of Foreign Affairs

MIT- Massachusetts Institute of Technology

MSI- Mauritius Strategy of Implementation

NGO- Non Governmental Organisation

ODA -Official Development Assistance

OECD -Organization for Economic Cooperation and Development

OECD-DAC - Organisation for Economic Co-operation and Development's Development Assistance Committee

PIF- Pacific Island Forum

SIDS -Small Island Developing States

SAARC - South Asian Association for Regional Cooperation

TICAD- Tokyo International Conference on African Development

UN -United Nations

UNAIDS- Joint United Nations Programme on HIV and AIDS

UNCED- United Nations Conference on Environment and Development

UNCTAD -United Nations Conference on Trade and Development

UNDESA- United Nations Department of Economic and Social Affairs

UNDP- United Nations Development Programme

UNICEF - United Nations Children's Fund

UN-OHRLLS - UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States

WB- World Bank

WTO- World Trade Organisation

# Introduction

Humans have the natural instinct of being pro-active and finding better opportunities for themselves and their kinship. Therefore, it is not a coincidence that countries, which consist of humans, similarly find ways and means of realizing socio-economic progress and ultimately aim at achieving sustainable development. This natural instinct which exists in humans is magnified to a greater level. However, it is important to recognize that not all countries are formed equally. Countries greatly vary in terms of their size and landscape of their territories, the land surface area, their geographical location, the quality of the top soil, the proportion of cultivable area, size of the population, their natural resource endowment etc…

To complement the natural conditions that cause a disparity in the economic and progressive statuses of countries, we need to recognize that humans have also contributed their part in widening the disparities and created further challenges and obstacles to development endeavours. For example, the history of various developing and under-developed countries, i.e. their independence struggles; their various cultural beliefs and also colonial legacies. Whilst a few colonies have gained an advantage in terms of infrastructural development such as, building of roads, airports, ports, schools, hospitals, administrative buildings etc…, many others were not so fortunate and did not benefit much. The colonial masters would simply use these proxies to extract resources and would not re-invest back.

Regardless of all the above factors, a 'special' category of countries, the Small Island Developing States, who have their own inherent challenges to development, are generally very resilient and the members of this 'special' group are the ones who graduate from Least Developed Countries (LDC) status to Middle Income Countries (MIC) status, according to the UN classification.

To elaborate on this special group further; one of the outcomes of the United Nations Conference on Environment and Development (UNCED) which took place in Rio, in Brazil, in 1992, was the first acknowledgment of the Small Island Developing States (SIDS) as a special group of countries which face many common challenges, as indicated under Agenda 21 of the outcome document of the UNCED, also known as the Earth Summit.

The UN Office of the High Representative for the, Landlocked Countries, Least Developed Countries and Small Island Developing States (UN-OHRLLS) defines SIDS as "a distinctive group of developing countries facing specific social, economic and environmental vulnerabilities." SIDS are mostly located in three main regions of the world and composed of three groups namely; the CARICOM- (comprising of Islands in the Caribbean) the Pacific Island Forum (PIF) (which comprises of Islands in the Pacific), and the AIMS Group (i.e the Islands of the Atlantic Ocean, Indian Ocean, Mediterranean and South China Sea). However, from the latter AIMS group, only the Indian Ocean Islands of Comoros, Madagascar, Mauritius and Seychelles (CMMS) belong to a regional cooperation body which is the Indian Ocean Commission (IOC).

The SIDS are highly vulnerable because, firstly, their narrow resource base prevents them from being able to generate economies of scale. SIDS have small domestic markets and also depend heavily on few external and remote markets to sell their goods. SIDS often face many barriers such as higher expenditures for energy, transportation, infrastructure, communication and servicing, as a result of being far from the main export markets and from the main ports from which they import their goods.

Furthermore, low and irregular international traffic volume increases the cost of transporting supplies to SIDS because shipping companies find it more cost effective to deliver cargo to major ports, only stopping at smaller ports en route to their destination. In addition, the piracy activities in the Gulf of Aden and in the Western Indian Ocean has further increased the cost of shipping goods to SIDS in the CMMS group, as insurance companies are charging very high fees, as the risks are high and cost for armed security personnel on-board is passed on to the recipient countries, which are mainly the SIDS.

In addition, SIDS have limited resilience capability to handle natural disasters, as was evident in 2004 when the Tsunami generated by the Earthquake off the coast of Indonesia hit a number of these SIDS.

Also, their small, yet growing populations mean that SIDS do not have sufficient human resource personnel to keep pace with economic growth.

Many SIDS have graduated from Least Developed Country (LDC) to Middle Income Country (MIC) based on three criteria determined by the UN Committee for Development Planning (CDP), established by the Economic and Social Council in 1965. In order to graduate, the country must cease to qualify for two out of the following three criteria:

- Gross National Income (GNI) per Capita
- Human Assets Index (HAI)
- Economic Vulnerability Index (EVI)

Given that a country only needs to qualify for two criteria, many SIDS graduate to MIC status, and in the process, the EVI is often overlooked. This entails that, as a MIC, SIDS lose the benefits such as Overseas Development Assistance (ODA), preferable concessionary loans and preferential trade treatment, whilst, remaining highly vulnerable to the aforementioned factors and conditions.

This paper will demonstrate that SIDS are left to fend for themselves when they graduate from LDC to MIC status, as they cease to qualify for the benefits previously obtained as an LDC. In effect, this means that SIDS are not necessarily better off because they remain highly vulnerable. This has severe negative consequences as SIDS run the risk of falling back to LDC status.

This paper is divided into **five chapters**. The **first chapter** follows the introduction and contains a literature review consisting of a summary of research that has already been conducted on the graduation of SIDS to MIC status. It will also include a critical analysis of this topic.

**The second chapter** includes a theoretical construct underpinning the main argument of this paper, whilst it also reviews the various theories which exist under this topic, and finally adopts a theory which supports this topic. **Chapters III** explores the specificities of Small Island Developing States, looks at the various classification models and also highlights the graduation experiences of various SIDS. **Chapter IV** studies the impact of the graduation on SIDS and also explores the type, use and effectiveness of Overseas Development Assistance (ODA). **Chapter V** looks at Maldives as a case study of a SIDS who has recently graduated from LDC to MIC status.

This paper ends ultimately with the **Conclusion** where the fact that SIDS are not better off when they graduate to MIC status, is highlighted. Some measures to address this are then proposed.

# Chapter 1

## Literature review

A wide range of written materials were used to prepare for writing this paper. In order to be abreast on current SIDS development issues and the general issues related to SIDS, I have relied mostly upon journals, articles, books, news briefs, press releases posted on the websites of SIDS newspapers and the official website of the UN, UN-OHLLS UNDESA, the AOSIS as well as other relevant international websites.

Government websites, articles, the MFA of Seychelles' database along with statements released by both local and international NGOs, were critically important to the understanding of the inherent vulnerabilities and challenges that SIDS face. Many sources were reviewed using the internet.

However, for the sake of this research, it is important to point out that information on SIDS in general, the graduation of SIDS to MIC status, the impacts of foreign aid on SIDS are not abundantly available, as compared with other categories of countries such as the lower income countries, for example, sub-Saharan Africa. Here, information on the impact of foreign aid is widely available. It has helped that I come from a SIDS myself and working for the Government means that I have access to some information which I would have otherwise not had.

On the topic itself, the literature in general is very much divided. Some scholars/writers believe that when a country graduates from LDC to MIC status, it means that they have made some progress and it is important that they 'stand on their own' and this means that they should lose the benefits that they were previously receiving. On the other hand, and this emanates from writers originating from SIDS mostly, with some backers from the developed Nations, is the view that because of their inherent vulnerabilities, SIDS do need to keep on benefitting from special treatment, otherwise they risk losing all progress made.

The literature on foreign aid is quite abundant where most proponents are of the view that foreign aid creates dependency and thus prevents the recipient country from implementing reforms and adopting sound economic policies, and following progressive paths, often leading to corruption or misuse of funds. Again, the general view/position from the Islanders is that foreign aid has been vital to their progress and development endeavours. SIDS in general, have exemplary track records on good governance and on the implementation of sound economic policies, transparency and accountability; and foreign aid has been the catalyst for growth and development.

This research has also depended significantly on the documents from the UN database and also from the databases of multilateral organizations such as the World Bank, the IMF, UNCTAD, UNDESA etc…

# Chapter 2

## 2.0 Analytical and Theoretical Outline

### 2.1 Addressing the problem of the Statement by identifying the ideal development model

In general terms, the SIDS economies are small, as compared to the other economies; particularly their human resource bases are very slim, with natural resources and domestic market being both greatly limited. A narrow human resource pool means that human resource bottlenecks can appear in various areas of economic activity. The limited range of local skills usually means that a small number of persons are needed to undertake a wide range of tasks. In effect, small countries tend to have a great number of 'generalists' and limited 'specialists'. This stretching of 'skilled' and 'semi-skilled' human resources sometimes means that there are shortfalls in administrative, managerial, executive, technical and operational areas which often are not noticeable until certain operations are fully studied. Many SIDS rely on immigration to alleviate the human resource deficiency problems.

SIDS are also characterized by small domestic markets for an extended range of goods and services. Demand for domestic goods and services are diverse, and income distribution is somewhat uneven, and numerous production operations cannot be processed at an optimum economic level if they are to depend mainly on the local market. It is worth noting that exports play a dual role in the economy of SIDS. Firstly, it can be viewed as a channel for

increasing production and, therefore, creating more employment opportunities. Secondly, it generates foreign exchange required to purchase imports that are used for consumption and production purposes. Given the specific or concentrated nature of domestic production relative to a varied domestic demand structure, imports are generally high relative to domestic production.

Small island countries have no option, but to interact with the international community (Governments, Financial Institutes, Businesses, and Organizations) on a frequent basis. Variations in the global environment can therefore influence the economy and society of SIDS. Further to the recent activities in the global economic climate, linked to the globalisation phenomenon, and the opening up of trade regimes, the removal of trade barriers, the introduction of trading blocks, the creation of Regional Economic Communities (RECs), improvements in Information Technology and the elimination of special trading privileges mean that SIDS must reconsider their development agendas. Moreover, SIDS are exposed to natural hazards such as landslides, hurricanes, floods, tidal waves, earthquakes and volcanoes, which can negatively affect the socio-economic welfare of the people. In addition to the delicate eco-systems that are also found in SIDS.

As identified above, in spite of the negative factors that affect SIDS, several SIDS have managed to provide a high living standard for their people. SIDS have made remarkable efforts at both the local and regional levels to implement the Barbados Programme Of Action (BPOA) followed by the Mauritius Strategy of Implementation (MSI). Furthermore, SIDS

have managed to mainstream sustainable development practices into their policies, national development plans, and strategies, and also undertaken political commitments to raise awareness on the importance of sustainable development concerns.

SIDS have spearheaded the process in calling for practical, ambitious and urgent actions to address climate change, to protect local biodiversity, and to implement strategies for promoting alternative energy. SIDS have made different progress levels with regards to the realisation of the Millennium Development Goals (MDGs) and other international development goals, specifically in the areas of gender balance, environment, education, and health.

SIDS have successfully created partnerships to forward their sustainable development agendas. These also relate to SIDS-SIDS cooperation programmes and partnerships implemented at intra- and interregional levels. As a result of these sound policies, SIDS have managed to make the leap from LDC status to MIC status. This paper will now explore two theories for SIDS to sustain their status once they have graduated to MIC status, namely-the Export Diversification Model and the Development Aid Theory.

### 2.2.0 Export diversification model

### 2.2.1 Definition of Export diversification

Export diversification can be defined as a "change in the configuration of the country's standing export product profile or export markets" (Ali, Alwang and Siegel, 1991), or "as the range of production over many sectors" as stated by Chauvin and Berthelemy (2000). In the context of SIDS, export diversification is considered as a shift from traditional to non-traditional exports and this, is in line with their export led development strategy. In offering a larger export base, diversification can stabilise revenue from export. It can also increase returns and encourage progress across various sectors such as increased technological know-how through comprehensive training in both technical and scientific areas, in addition to learning from experience. Moreover, in simplifying forward and backward links, this causes input from specific manufacturing undertakings to affect output of other undertakings; increased dynamics of foreign markets, bigger economies and outside influences, and the replacement of goods whose prices have been increasing with those which prices have been decreasing.

### 2.2.2 Various facets of export diversification

According to the World Bank "Export diversification may take numerous dimensions and may be analysed at different levels. There are two prominent forms of export diversification: horizontal and vertical. Horizontal diversification occurs within the same sector (primary,

secondary or tertiary), and requires alterations in a country's export output by adding new products on existing export mix within the same sector, with the aim of lessening adverse economic and political risks."

On the other hand, integrating vertical diversification in the local manufacturing process requires an adjustment from the three basic sectors i.e. primary, secondary and tertiary. It requires planning ahead to maximise undertakings to add value to current products. These undertakings include advertising, manufacturing etc… Vertical diversification may increase the prospects of primary goods and boost growth given that finished products tend to have greater price stability than primary goods.

Diagonal diversification is the third dimension (lesser-known) of export diversification. It means a change from input which has been imported towards the secondary and service sector.

The needs to effectively adopt the three types of diversification differ significantly and can only be adopted on a case by case basis. Factors required include trained human resources, funding, entrepreneurship and public relations skills. In order to reach sustainable export in the long run, there needs to be a combination of the three types of diversification i.e. complimenting current products with newly introduced ones (horizontal diversification); and upgrading from primary goods to those with a higher added value (vertical diversification), and thirdly diagonal.

Consequently this objective will be met by regulating the amount of goods in the current batch meant for export or introducing newer goods in the batch.

Stages of Diversification: Diversification of export may be considered at different stages from farming, plants, regions, country, or regional levels. At all levels, emphasis ought to be placed on the three types of diversifications: horizontal, vertical, or diagonal.

### 2.2.3 Benefits of Export Growth

Export growth is very important for all countries based on the following:

On a macro level:

(i) Exports help to accumulate foreign exchange;

(ii) Export earnings are critical to finance import and exports;

(iii) The smallness of SIDS means that they need to identify bigger markets

(iv) Exports contribute to employment and growth of local product.

On the flip side, on a micro scale, it is commonly agreed that companies that export their products are more competent than those which serve the local markets; additionally the former being a channel for technology transfer. Moreover, these companies produce technological knock-on effects which result in positive backward and forward linkages to the local economy. Processed goods for exports are generally highly labour intensive, particularly

when raw materials are obtained locally. Therefore proving that companies that produce goods for export purposes are more efficient than their counterparts who focus solely on the local market and thus resulting in significantly greater economic growth.

### 2.2.4 Application of the export diversification model in SIDS

International trade is very important for SIDS as their economies are greatly dependent on such trade for generating national income and government earnings. Nonetheless, SIDS are very minor actors in international trade. Their share in world trade accounts only for a minute proportion of less than 0.01% of global trade. Moreover, this share is on a diminishing trend, highlighting slower trade expansion of SIDS as compared to developed countries and developing countries in general. The export structure of SIDS is categorised by the concentration in a small number of export products and export markets.

In this regard, the economies of SIDS are greatly vulnerable to the international trading platform. One of the most important key issues for export diversification for SIDS are market access constraints of major export markets, often on a preferential basis, and price instability of primary products of export which are of interest to them.

Therefore, SIDS face a variation of challenges and opportunities in the progressive world trading system and regional trading structure. The efforts of developing countries, including SIDS, to advance export extension and diversification towards a more value-added downstream processing segment of industries has often been restricted by market access

barriers in their major markets. One such hindrance is the presence of tariff peaks and tariff escalation. Tariff peaks are defined as those tariffs of more than 15 per cent ad valorem in developed countries. Tariff escalation happens when processed products are charged with higher tariff rates than those applied to primary commodities, thereby providing higher protection to domestic processing industries. In those markets where tariff escalation persists, the importation of primary commodities is encouraged while imports of manufactured goods are discouraged.

Similarly, as regards to exports, SIDS are faced with particularly vulnerable trading environment emanating from their export structure. In general, SIDS export is vastly dependent on a bundle of limited number of commodities and export markets.

Primary commodities occupy a principal place in the export structure of SIDS, although it is worth noting that services trade is becoming increasingly important for a number of them. However, the varieties of commodities exported by SIDS are often limited and sometimes those countries are heavily dependent on those few products as a source for foreign exchange revenue. Agricultural, mineral, fishery and forestry, as well as textiles and garments are the main products exported by SIDS.

As discussed above, diversifying one's export base is instrumental for economic growth and progress, at both micro and macro levels, it is important to recognise that in reality this is not easily achievable for SIDS. The main reason being that there are limited raw materials to

begin with. Therefore limiting the scope for economic progress culminating thus in other types of risks such as social and political. Moreover, SIDS do not have the necessary resources to effectively shift towards the production of new types of goods, and to invest in research & development, infrastructure development, institutions etc. This goes back to the point that SIDS do need assistance to sustain their economies and overall progress, therefore, the market diversification model is not suitable for SIDS.

### 2.3.0 The Development Aid Theory

#### 2.3.1 What is development aid?

According to the OECD (2003), Development Aid is "Flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent."

Aid can take two forms: (1) bilateral- provided at country to country level (2) multilateral- provided by a donor to international agencies and subsequently channelled towards the LDCs. The present ratio is 70% bilateral to 30% multilateral.

#### 2.3.2 Origin of the Development Aid theory

The notion of ODA dates from the imperialist period specifically towards the end of the nineteenth century. Free market capitalism was the prevailing economic system and this also

applied to the relationship between imperialist powers and their proxies. The non-interventionist policy adopted by the colonialist government led to problems such as product shortages.

A shift in the position of these governments and a growing consciousness as to their moral obligations meant that they became more involved in economic activities and thus trickling down the positive effects onto the proxies. This resulted in the provision of development aid to the poor colonies.

### 2.3.3 The effectiveness of Developmental Aid

Aid effectiveness is the measure of the impact of development aid and is quite a controversial subject. Peter Bauer, an economist contended in the 1960s that aid is ineffective. As he put it, it is "an excellent method for transferring money from poor people in rich countries to rich people in poor countries."

Recent studies have shown that there is no correlation between development aid and economic progress. Adversely, development aid can distort the local currency of the country receiving the funds, lead to corrupt practices and cause complacency where governments feel comfortable receiving foreign aid and refrain from changing their status quo by undertaking much needed political and socio-economic reforms.

In addition some scholars believe that aid was used to serve the agendas of donor governments by funding puppet leaders in recipient countries. Moreover there have been instances where private donations towards corrupt leaders have been masked as development aid, where this money should have been used for the benefit of the people/country but instead have gone into the pockets of a few and/or spent terribly.

Additionally, critics have levelled that there is a serious lack of understanding with regards to the norms and cultures of recipients. This has created the unfortunate occurrence that donor countries wish to impose their own modus-operandi and solutions onto them. Consequently, a newer approach is being adopted whereby eventual answers to problems are being conceived in line with the requirements of local cultures.

Another contention is that assistance in the form of direct cash has resulted in over-reliance and questionable corrupt practices. Consequently funds have been misdirected and not reached the intended recipients. This has negatively affected the domestic manufacturing sector. In consequence, donors have resorted to other means to provide aid to the specific sector, in the form of microcredit. There's also the case of countries who received late independence, they face a complex problem given that their ethnic diversity often leads to a power struggle within the country itself and thus making it challenging to provide aid.

Further reproach by critics concern the strings attached to the aid. An example of the obligations imposed by donors is the fact that recipients need to import products and services

from these same donors although, at less than competitive prices. An additional example would be forced liberalisation of the economy to allow foreign investors to come in.

Since the 1950s aid has been receiving critics who claim that it is mostly wasted, makes recipients more dependent by reducing growth and tax collection, and promotes corruption. Indeed, substandard aid can have all of these faults but the fact of the matter and despite all the noisy criticism, real aid is working. In the last 20 years, aid has helped to achieve excellent progress for human development and poverty reduction, especially in SIDS.

70% of the world's poor people are women, and aid which affects the social sectors – being health, education, water supply or social protection – is very likely to support women in particular, given that it provides the services that women otherwise have to provide themselves. Researchers have recorded stories of progress supported by aid, such as child health in Seychelles, rural water and sanitation in Comoros as well as rural roads and irrigation in Cape Verde.

Aid has contributed to halving the amount of people living in poverty since 1990 and reducing the number of children who needlessly die every day by 10,000. Real aid has empowered the people to improve the development process in SIDS by:

– Reducing gender inequality and fulfilling women's rights.

– Assisting them in holding their governments to account by supporting national audit institutions, parliaments, community monitoring organisations and a free and independent media,

– Improving tax revenue collection,

– Assisting the poor to save and invest more in their own businesses through microfinance programmes, for example in Mauritius.

– Increasing growth, which studies from the IMF concluded, when aid is particularly intended for this objective, can increase growth by 0.5-1.5% a year over several decades.

The actual success of aid can therefore also be measured in genuine sustainable development progress, which empowers the world's people to hold their governments to account, and which empower governments to develop their own economies.

"Research has shown that developed countries are most likely to provide aid to countries that have the worst economic situations and policies" (Burnside, C., Dollar, D., 2000). In theory, the ingredients required for a country to progress economically are the implementation of sound economic practices complimented by government transparency and accountability. Therefore with these factors present, combined with foreign aid from international donors leads to formula for success. However, in reality the poorer countries where the above-mentioned ingredients are missing are the ones who obtain the most aid. Therefore, this ties in with the thesis statement that when SIDS graduate they receive less aid than before although

it is important to point out that the aid was vital for the graduation to MIC status in the first place.

### 2.4.0 Conclusion

Further to analysing both the Export Diversification Theory and the Development Aid Theory, one may be tempted to argue that the Export diversification theory would be the best theory for SIDS to adopt after graduating to MIC. However, in order to diversify exports, several conditions need to be met, for example, erecting the proper infrastructure, conducting research & development, empowering human resource, adding value to products, etc…

Moreover, tariff & non-tariff barriers to trade also pose significant challenges for SIDS to diversify their exports. Also, SIDS are not endowed with a lot of natural resources, so it would be ultimately difficult to diversify when a small island state does not have many resources to shift export to. On the other hand, development aid, complemented by sound management policies, transparency, good governance, accountability- has resulted in some SIDS making progress and providing high standards of living for their people.

However, in order to be self-sufficient the SIDS still require the development aid that was being provided to them as LDCs. Therefore, for the purpose of argument of this paper, the development aid theory is more applicable to SIDS both before and after graduating to MIC status

# Chapter 3

## 3.0 Country Classifications

This chapter provides a description of several groups of countries in special positions, particularly: - the LDCs, SIDS and Small Developing States. The aim is to highlight the development constraints of these countries, and to highlight the notion of economic and environmental vulnerability – the contemplation of which is, indeed, important in designing and implementing ideal development strategies and effective bilateral & multilateral co-operation programs.

The specificities of Landlocked Developing Countries (LLDC), mountain developing countries, post-conflict countries and Low Income Countries Under Stress (LICUS) are also briefly highlighted, whilst also briefly looking at examples of other special situations.

## 3.1 Least Developed Countries (LDCs)

### 3.1.1 The Establishment of the LDC Category

Generally, LDCs may be defined as low-income countries with low human capital and high economic vulnerability. Considering the multitude of economic disadvantages faced by these poor countries, the United Nations (UN) introduced, in 1971, through its Committee for Development Planning, the LDC category. The introduction of the LDC list was mainly

intended at providing these countries with special conditions – particularly, international advocacy of preferential and differential treatment for LDCs - that would allow them to compete, on equal or at least better terms, with more developed countries. Therefore, the LDC list was created in acknowledgement of the various disadvantages faced by these countries, which tend to significantly obstruct their ability to promote sustainable development. Moreover, the essential purpose of instituting the LDC category was to guarantee a level playing field in the global arena whereby small, as well as large nations of the world, can engage one another.

According to the World Bank, with the addition of Timor Leste in 2003, currently the LDC list is made up of a total of 49 countries, spanning across three continents (Africa, Asia Pacific and the Middle East). Africa clearly takes the lead since 34 out of 49 LDCs are, in fact, African countries, signifying, therefore, 69% of the list.

Since its introduction in 1971, constant reviews of the LDC list have been made. In the 2006 triennial review of the list of LDCs, and following recommendations made by the Committee for Development Policy (CDP), the Economic and Social Council of the United Nations (ECOSOC) used the following three criteria for recognising LDCs:

• A "low-income threshold, based on a three-year average estimate of Gross National Income (GNI)", according to which a country is included in the LDC category if its per capita GNI falls under $750 and graduated if it rises above $900;

• A "human resource weakness criterion, measured through a Human Assets Index (HAI) that includes indicators of nutrition, health, education and adult literacy";

• An "economic vulnerability criterion, measured through an Economic Vulnerability Index (EVI)" based on the following indicators:

(i) Instability in agricultural production;

(ii) Instability of exports of goods and services;

(iii) The economic importance of non-traditional activities, i.e. the share of manufacturing and modern services in Gross Domestic Product (GDP);

(iv) Merchandise export concentration;

(v) The handicap of economic smallness, measured through population size;

(vi) The ratio of people displaced by natural disasters; and

(vii) The country's remoteness.

In this vein, it is critical to stress that the CDP does not consider that vulnerability caused by government policies should be taken into account.

According to the CDP, in order for a country to be included to the LDC list, it must meet all of the three criteria stated above. Moreover, its population size must not surpass 75 million people – a rule unequivocally adopted by the CDP in 1999. The UN anticipates the development partners of LDCs to take into consideration (through aid and other development instruments) the structural handicaps LDCs have to face. The CDP also acknowledges that the

establishment of LDC qualification criteria is a work-in-progress, as knowledge of matters evolves and new data become available. In fact, the criteria for inclusion on the LDC list have been revised in many instances. The CDP emphasizes that “the identification of least developed countries should be viewed as a dynamic and open process, requiring periodic refinement of the criteria, in the light of socio-development and on-going improvements in and the availability of reliable and internationally comparable data."

In particular, the CDP acknowledges that one of the key indicators it uses, the EVI, needs “to be refined progressively, as to its content, and (…) be supplemented by the consideration of other important elements of vulnerability which (…) are not yet taken into account.” For example, there was a discussion, within the CDP, on whether or not an e-readiness criterion should also be included to the group of indicators for considering the list of LDCs, given the vital importance of Information and Communication Technologies (ICT) in supporting development and eradicating poverty.

### 3.1.2 Positive Discrimination: Benefits with being LDC Status

As stated above, the key purpose of establishing the LDC category is to guarantee that these countries will have access to international support measures that assist them address their structural handicaps and, thus, make the realisation of sustainable development possible. As stated by the CDP in 1999, “least developed countries are low-income developing countries

that are in need of specific international measures to remove the handicaps constraining their development."

The benefits linked with being a least developed country status falls primarily into three principal areas: technical cooperation, multilateral trade; finance for development. Particularly, LDC status is known to have access to special treatment in the following areas:

• Official Development Assistance (ODA);

• Preferential market access for products from LDCs;

•Have exemption from obligations to implement World Trade Organization (WTO) agreements; and

Access to programmes and special measures and of technical assistance provided by various international agencies, particularly the International Monetary Fund (IMF), UN Development Program (UNDP), the UN Conference on Trade and Development (UNCTAD), International Trade Centre (ITC), , the World Bank (WB) and WTO, under the Integrated Framework for Trade-Related Technical Assistance to LDCs.

According to Johnson (2006), “the benefits granted by multilateral organizations include non-reciprocal preferences, exemption from the obligation to reduce trade barriers, and favorable treatment for certain LDC exports”, with the European Union’s Everything But Arms (EBA) Initiative and ACP Agreements representing solid examples. Furthermore, LDCs also obtain

substantial benefits from multilateral arrangements, including the United States' African Growth and Opportunity Act (AGOA), Japan's-Tokyo International Conference on African Development (TICAD) and China's- Forum on China-Africa Cooperation (FOCAC).

It is also worth noting that concessionary financing provided through co-operation framework does not allude to the fact that a country is from the LDC group as a factor to obtain funding. Therefore, contrary to the norm, the main determinant of the aid received by LDCs is not their status as such. According to UNCTAD, the bearing of being an LDC on the attribution of ODA to LDCs is tough to calculate and, by and large, believed to have been inadequate. The majority of ODA recipients and other financial assistance have been allocated under criteria other than LDC status, with per capita income – complemented by political stability and the countries' creditworthiness – being definitely the most important criterion considered by international donors when prioritising where to provide ODA.

Consequently, up until 2010, UNCTAD had estimated that, as low-income countries, a total of 42 LDCs and 23 non-LDCs had benefited from several concessionary financing facilities, "a treatment which (…) seven 'lower-middle income' LDCs cannot necessarily expect," despite their status as LDCs.

In general, there is a gap between international support initiatives (supposedly) due to LDCs and the actual benefits that international development partners provide to these countries with inconsistencies mainly in the area of development financing. Discrepancies between what has

been promised to LDCs and what has actually been allocated are also recognized in areas such as market access and technical assistance, which have not been implemented as fully, or as promptly, as expected. Furthermore, trade preferences offered by virtue of LDC status have remained underutilized due to non-tariff barriers obstacles.

## 3.2. Small Developing States

### 3.2.1. An Attempt at defining Small States: The Relativity of Size

When determining the size of countries, in order to measure smallness thresholds (i.e. to decide what exactly constitutes a small country), the existing literature takes into consideration the following economic and geographic indicators:

(i) population size,

(ii) GDP,

(iii) geographical area, and

(iv) A country's terms of trade.

Nevertheless, since dimension and size are, according to Read (2001), relative concepts, no precise definition of small States has ever been agreed upon. This is also because the notion of size will significantly depend on the issues being taken into account.

Research carried out by the Commonwealth Secretariat (2000) has concluded that "no definition, whether it be population, geographical size or UNCTAD (2002): GDP, is likely to be fully satisfactory." As a matter of fact, "the dividing line between small and large countries changes throughout history, as population grows, and, on the other hand, as the number of countries changes."

As a result of the absence of a consensual definition of smallness, random cut-off points and less-than-rigid boundaries have been employed by various authors over the years, to distinguish between small and large states. For example, the Commonwealth Secretariat acknowledges the existence of a total of 45 small States.

The fact of the matter is that small developing countries in general – be they micro States (with a surface area no larger than 1,000 $km^2$) or very small States – do share a lot of the same smallness characteristics and economic challenges.

Despite the lack of consensus concerning the definition of small States and the differences around the determination of smallness threshold, it is commonly agreed that many of the following characteristics are present in most small States, which explain their development constraints and vulnerabilities:

- Small population,
- Limited natural resources,

- Small-sized internal market,
- Deficient domestic capacities,
- Scarce domestic demand,
- Limited production diversification,
- Vulnerability,
- Weak institutional arrangements,
- Remoteness and insularity,
- Propensity to natural disasters,
- Openness, access to external capital,
- Income instability and poverty.

Actually, most small States present some common characteristics, the understanding of which will simplify the implementation of development and poverty reduction policies. It is, however, vital to note that, despite the afore-mentioned similarities, small States are a very diverse group.

To this effect, it would be difficult to produce a one-size-fits-all theory dedicated to these countries. In fact, experience shows according to the World Bank, “each small state is unique and needs to address its development prospects in the context of its own historical, cultural and social realities." For this reason, policy options will, necessarily, have to be customized to specific regional and country circumstances.

### 3.2.2. The Effect of Size on Economic Growth

It is commonly agreed that small countries experience significant obstacles to economic growth, often enjoying lower long-run rates of economic growth than larger countries, particularly because of their small size. For example, on the LDC list, composed of a total of 49 countries, 16 are considered small States, representing around one third of the LDC category (32%). For these countries, development constraints may be more vital than LDCs with a larger land mass. In truth, small States' economic structure is negatively affected by their constraints in achieving sufficient economies of scale in a wide range of basic economic activities.

In addition, the small size of the local market, the limited domestic resource base and the narrow platform for domestic output, exports and markets are all negative aspects that small economies need to, forcibly, contend with.

Therefore, all in all, small size is generally considered an impediment to economic growth given that it renders small states sub-optimal in economic terms.

According to Read (2001), "the imperfect market approach provides the theoretical framework that explains the economic sub-optimality of small States, notably the critical negative impacts of diseconomies of scale, indivisibilities (namely in the provision of public services), lack of both efficiency and competitiveness, and diseconomies of scope. These are

factors that greatly curtail small States' ability to undertake sound and reliable economic activities."

Consequently, in small States, it is normal for a relatively large proportion of the economic activities to be focused in the public sector. Small States are also known to have a structural, intrinsic openness to trade.

This is because smaller economies tend to depend greatly on external trade and on foreign direct investment in order to overcome their scale limitations. The high concentration of trade volume, necessary because of their strong dependence on both imports and exports, requires small states to guarantee that they are internationally competitive.

This being the reason; small States are known to be more inclined to upholding growth-conducive, export-friendly policies than large economies, gaining, with the implementation of these policies of course, significant gains from trade. Although, it is also correct that small economies' openness to trade, though strong, cannot definitively address the negative effects of small size because of the increased exposure to exogenous shocks. Related to exogenous shocks is the fact that small economies in general have a limited ability to affect domestic prices, a situation that combined with other factors (…) results in a high vulnerability to global economic conditions." moreover, small States' growth rates tend to be unstable since these countries face a relatively higher external exposure.

In fact, the general view of the literature is that any potential advantages for small states conferred by their small size are greatly overshadowed by their inherent disadvantages. This suggests that small states are most likely to experience challenges in generating and maintaining economic growth as opposed to larger states.

Evidence demonstrates that, to be able to ensure economic robustness, the size of a country matters. Smallness presents countries with inherent negative effects, in terms of their economic performance and integration into the global economy, imposed mainly by disadvantages related to the size of the territory and, subsequently, low population density.

According to Read (2001), the viability of small States was strongly contested by a number of early studies, which argued that the economic challenges these countries are forced to deal with – namely diseconomies of scale – are so great that their independence should not even be considered. However, experience has proven the exact opposite in many instances, with an increase in the number of autonomous small States. Fortunately, this pessimistic perspective has not been borne out by the continued survival and prosperity of an increasing number of small states in the global economy.

In effect, in spite of their small size, there are many cases of small States that have achieved, quite successfully, sustainable economic growth and fairly high levels of per capita income. This reality is reflected in disproportionately fewer small states being found in the World's Bank lowest income categories.

Hence, it may seem just, to conclude that small size is, by no means, an insurmountable drawback on the economic growth of small countries. Nonetheless, we have to acknowledge that the economic sub-optimality of small States hinders their scope for output specialization and domestic policy autonomy. It is also important to note that, statistically, both big and small countries have similar rates in economic growth and income per capita levels therefore showcasing that the existence of various additional factors have influenced the vulnerabilities of SIDS' small domestic markets inflated civil service and the distance from major markets.

Social cohesion is also known to be an important characteristic of small States, with vital economic implications. This structure can make possible and stimulate the creation of social capital through increased communal interaction and leading to greater consensus in economic management and policy-making.

Moreover, it is understood that, precisely because of their small size, these countries tend to be more adaptable to changes and more flexible in their policymaking, which expedites, to a greater extent, economic growth. On the flip side, it is particularly worrisome to find out that the proximity between decision-makers and constituents, a result of the country's small size, can also encourage "rent-seeking behaviour based upon family ties or clientelism," according to Read (2001).

### 3. 3 Small Island Developing States (SIDS)

#### 3.3.1. Defining SIDS?

Based on their economic specificities and the fact that these small and dispersed masses of land are many around the globe; it is particularly surprising to realize that there is no precise definition for what constitutes an island-nation.

From the 49 LDCs, 15 are small States, 10 of which are considered Small Island Developing States (SIDS), thus representing 66% of small developing states in general. It is, therefore, reasonable to claim that SIDS are a sub-group of small developing states.

The Alliance of Small Island States (AOSIS) – an ad hoc lobbying and negotiating group (created back in 1990 at the 2nd World Climate Conference) that represents the interests of SIDS (be they LDCs or not) within the UN system – currently has, among members and observers, a membership of 44 countries and territories (including non-self-governing islands), representing 28% of the world's developing countries and 20% of the UN membership. It is important to realize that AOSIS members include Guyana, Guinea-Bissau, Suriname and Belize- all coastal ,though not technically island nations. Moreover, Cuba, with a population of 11.3 million, is also a member of AOSIS.

In addition to the AOSIS list of SIDS, which Encontre (2004) considers to be a political list, there is also an economic list of SIDS (implicitly recognized by the UN and composed of 48 SIDS, including several non-autonomous territories), an institutional list of SIDS (46 SIDS identified by the UN Secretariat, including continental states and non-autonomous territories) and the UNCTAD non-official list of SIDS (composed of 29 SIDS, all self-governing).

Regardless of the discrepancies in the definition of SIDS and the absence of eligibility criteria to define an internationally agreed SIDS list, it is clear that island-nations are uniquely threatened by a number of economic constraints, which oftentimes challenge their survival and independence. Moreover, in addition to all the shortcomings mentioned in section 2.2 above, regarding the economic disadvantages of small States in general, SIDS are forced to deal with additional constraints, given their insularity, remoteness and (sometimes) difficult accessibility. In fact, SIDS face the following constraints: small size, remoteness and insularity, proneness to natural disaster, environmental fragility, high dependence on foreign financing sources and small population.

Remoteness is often translated into high (both local and international) transportation costs, the absence of communication infrastructure, and the challenging access to information technology, which are factors that significantly reduce SIDS' competitiveness and export revenue. These factors also increase the costs of imports, leading to substantial consumer losses. This condition results from the fact that many island-nations are located at great distances from the world's major markets and from research and development centres.

Regardless, a positive aspect of this same remoteness is that several isolated small island states lay claims to substantial maritime boundaries, by virtue of the demarcation of Exclusive Economic Zones (EEZ). To illustrate this, the EEZ of the Seychelles Islands is 1.3 million square Kilometres, which is roughly the same size as South Africa.

Susceptibility to natural disasters and environmental fragility are specific characteristics of SIDS. They are regularly threatened by floods, tsunamis, typhoons, hurricanes, droughts, desertification and volcanic activity. When these natural phenomena strike small islands, typically, the result is that economic activities come to a halt because of the widespread damages to the buildings, roads, ports etc…therefore resulting in losses in revenue.

Consequently, as a result of the disastrous nature of many of these disruptions, sizable income and development opportunities are regularly forgone. A good example would be; the Indian Ocean tsunami that affected Maldives in December 2004 resulted, based on a joint assessment by the WB and the Asian Development Bank, in the loss of approximately 60% of its GDP. This was primarily due to the negative impact of the event on the tourism sector, which obligated the UN to suspend its prior recommendation to graduate Maldives from the LDC category.

Further problems SIDS have to cope with include the fast deterioration of limited agricultural land, the increased demand for non-renewable energy resources, a high ratio of coastline to land area, the detrimental use of coastal areas for tourism purposes, excessive fishing activity

(by both local and foreign fisherman/vessels) and the lack of natural resources, which includes drinking water. Moreover, the rise in sea levels – a direct consequence of global warming and climate change – imposes serious threats to the very existence of Small Islands.

The high dependency of SIDS on foreign financing sources is another troublesome characteristic that requires close attention, especially since, according to Schmidt (2005) "development aid to island-nations reduced from a total of US$ 2.3 billion in 1995 to a total of US$ 1.7 billion in 2005."

The effects of SIDS' having small population include the reality of a relatively small pool of skilled labour, a high population density, which leads to a high demand on resources, and a higher tendency for large-scale emigration resulting in massive brain drain, which deprives Small islands from much-needed human resources.

Conversely, as a result of emigration, SIDS are also known to be the recipients of significant inflows of emigrants' remittances. Other positive aspects favouring SIDS also include the following: a higher life expectancy at birth, higher rates of literacy, and political stability.

## 3.4 On the Concept of Vulnerability

Vulnerability has been defined by UNEP as “the potential for attributes of any system, human or natural, to respond adversely to events” or, in simpler terms, as “the risk of being negatively affected by shocks.”

### 3.4.1. Emphasis on Environmental Vulnerability: The Threat of Climate Change

These shocks, which may be endogenous or exogenous in nature, can also be referred to as ‘negative unforeseen events’ and can occur, basically, from:

(i) Environmental phenomena, namely, hurricanes, prolonged droughts, earthquakes, tidal waves, volcanic activity, locust invasions, etc.

(ii) Economic constraints, uncontrollable by local governments, such as a fast decline in the international price of a country’s main export product, instability in interest rates on global capital markets or limited access to credit,

(iii) Political instability or

(iv) social pressures caused, e.g., by an upsurge in criminal activities, deterioration of the public health system, deterioration of public infrastructures, brain drain, inter alia. It is important to keep in mind, as opposed to economic and environmental shocks; political and social instability are vulnerabilities caused primarily by endogenous factors.

Based on a recommendation from the CDP, there should be a distinction between economic vulnerability and ecological fragility (that is, vulnerability of the ecosystem), though ecological factors often aggravate economic vulnerability. Moreover, the CDP states that “an important distinction should be made between structural vulnerability, which results from factors that are relatively impervious to national policies, and the vulnerability deriving from economic policy, which results from choices made in the recent past, and is, therefore, conjectural."

Small Island States are known to be principally vulnerable to exogenous, unforeseen events and SIDS are even more so. As a matter of fact, according to Encontre (2004), “smallness is the most significant factor of economic vulnerability, which is based on the argument that permanent structural handicaps are crippling factors of economic vulnerability of no lesser importance than external shocks beyond control." Read (2001) is also clear in pointing out that small States in general are “more vulnerable to external economic, strategic and environmental events over which they have little, if any, control."

As a result, the “vulnerability hypothesis," referred by Read (2001) proclaims that small States are subject to disproportionately greater instability than larger states, possessing fewer resources to alleviate negative shocks. For this reason, there are higher costs and risks in attempting to promote growth and development in small States in general, and in SIDS in particular, which can only be partially offset by appropriate endogenous strategies.

For SIDS, their vulnerability results basically from structural factors, given their isolation and higher-than-average propensity to natural disasters, worsened by their intrinsic income volatility, resulting from low diversification in production and trade and high export dependence. According to data presented by the CDP in 2003, 24 of the 33 most vulnerable states are island-nations, which is to say that 72% of the most vulnerable states are SIDS. In addition, according to Encontre (2004), evidence collected by CDP has shown that SIDS are economically more vulnerable than non-SIDS developing countries by 17.5%.

Thus, the CDP "has fully recognized that small countries are economically more vulnerable to external shocks than large ones because their economies are heavily dependent on external trade, are less diversified and suffer from diseconomies of scale. In particular, most small islands and landlocked least developed countries face a range of structural handicaps, such as high international transportation costs and relative isolation from major world markets." This is measured by the UN Economic Vulnerability Index (EVI). See Section 3.2.1 below.

### 3.4.2. Economic Vulnerability Index

The economic vulnerability of poor and structurally handicapped countries has been acknowledged since 1971, the same year that the LDC category was established. However, it was only until the early 1990s that the thought of measuring economic vulnerability, through the construction of an index, came to light.

In 1991, at the International Conference on Islands and small States, which was held in Malta, the necessity to construct a vulnerability index to highlight the special problems of small States, and the special treatment they consequently merited was officially recognized.

The following year (1992), UNCTAD commissioned a study to explore the viability of constructing an Economic Vulnerability Index (EVI), a matter that was raised at a conference on SIDS, which was held in Geneva, in July of that same year.

Furthermore, in 1994, the outcome of the Global Conference on the Sustainable Development of SIDS, otherwise known as the Barbados Programme of Action for the Sustainable Development of SIDS, acknowledged the need to adopt an EVI, -"a tool that was expected to demonstrate that SIDS were generally more vulnerable than other countries." However, this Programme of Action did not elaborate on the envisaged use of the EVI.

Subsequently, in 1997, faced with the prospect of being graduated from the LDC category and, hence, having to forego the special treatment associated with LDC status, Vanuatu, both an LDC and a SIDS called, at the UN General Assembly, for the creation of a vulnerability index to be used as a criterion for identifying LDCs. Consequently, UN General Assembly resolution A/52/210 of 18 December 1997 and ECOSOC resolution 1998/39 of 30 July 1998 were adopted, withholding Vanuatu's graduation and requesting that the CDP assess the practicality of constructing such an index. This, in turn, led to the introduction of this criterion in the methodology for reviewing the list of LDCs, with the CDP proposing, in replacement

of the Economic Diversification Index (EDI), which was being used since 1991, with the establishment of an EVI.

Consequently, in 2000, the EVI produced by the UN, initially integrating a simple weighted average of five components, was first developed by the CDP for that year's review of the list of LDCs. UNCTAD was key in encouraging the CDP and relevant inter-governmental bodies that a criterion of economic vulnerability should be introduced in the process for recognizing LDCs.

The EVI evolved as the years progressed. It now also includes individual indicators relevant to the following:

- instability of exports of goods and services,
- merchandise export concentration,
- the share of the primary sector in GDP,
- population size,
- instability of agricultural production,
- the percentage of people displaced by natural disasters.

In academic circles, the "dominant methodology for the measurement and empirical analysis of vulnerability is based on (…) an index, originally developed by Briguglio," in 1995. This index, initially a weighted composite measure of three fundamental causes of vulnerability,

namely small size (comprising 50% of the total weight), insularity/remoteness and propensity to natural disasters, was intended to take into account the specific challenges faced by small countries.

Measured by openness to trade, the share of transport costs in trade and the cost of natural disasters respectively evolved since then, incorporating components such as economic openness, dependence on a narrow range of exports, dependence on strategic imports, peripherally, economic vulnerability and resilience.

Briguglio's initial approach has also been the base of the work first developed, in 1998, by the Commonwealth Secretariat in creating its own economic vulnerability index, which includes the following variables: income volatility, export concentration, export dependence, the effect of natural disasters and GDP to measure resilience.

In 2003, Briguglio, alongside Galea, played, once again, the principal role in another significant development, constructing a Vulnerability Index Adjusted for Resilience, "in which 50% of the weight is assigned to the vulnerability components, and 50% to the resilience component" (typically, GDP per capita adjusted for Purchasing Power Parity). Contrary to Briguglio's and the Commonwealth Secretariat's economic vulnerability indexes, the UN's EVI was produced with the purpose of identifying LDCs and, therefore, cannot be generously applied to SIDS. For example, according to the Commonwealth Secretariat's index, nearly all SIDS are considered highly vulnerable whilst the UN index puts islands such

as Jamaica, the Maldives, Fiji, Barbados, and Mauritius among the 50 least vulnerable states. It is, therefore, vital for policymakers to keep these methodological issues in mind when assessing the economic vulnerability of countries, as the use of different indexes will, certainly, generate different and at times contradictory results.

The CDP is currently "considering how the notion of remoteness of countries could be included in the economic vulnerability criterion (…). Noting the importance of e-readiness for development, the Committee will also reflect on whether that factor might be taken into account." (Pereira 2005)

### 3.4.3. Environmental Vulnerability: The Threat of Climate Change

According to UNEP, Sopac (2005), the "environment is unequivocally the life support system for all human endeavours." Therefore, although climate change is an undisputably global threat, it is particularly a serious and possibly catastrophic problem for SIDS, given their inherent ecological fragility. For island-nations in particular, Schmidt (2005) states that the troublesome issue is that, due to global warming, "the average global sea level rise has increased 50% during the past 12 years. If this development continues, in a worst-case scenario, it is projected that the lives of more than 100 million people, especially from island-nations and coastal communities, would be negatively affected as these countries would simply be permanently flooded, which would challenge their very existence. Therefore, low-lying islands are particularly vulnerable to the effects of typhoons and hurricanes whilst global warming, and a rising sea-level will affect their long-term habitability.

Moreover, study from the Massachusetts Institute of Technology (MIT) indicates “hurricanes in both the Atlantic and Pacific Oceans have become 50% stronger during the last 50 years, which explains the reason why, lately, many SIDS have been battered by storms of increased ferocity."

In effect, because of global warming, weather events have become noticeably more intense, greatly worsening SIDS’ vulnerability to climate change and seriously deteriorating the already fragile economic situation of Small Island States.

This is mainly true when we ruminate other consequences of global warming, mainly changes in agricultural and food production, loss of biodiversity, damages to coastal reef etc. In effect, environmental factors are of vital importance to Small Islands in that their unique eco-systems and bio-diversity are highly sensitive to environmental infringements. Furthermore, according to the UN, it is acknowledged that during the 1990s, SIDS became more vulnerable mainly due to climate change and sea level rise.

Additionally, SIDS also experience the exhaustion of natural resources, namely minerals, forests, freshwater and fish stocks, and oftentimes bear the costs that come from the international community’s failure (lack of will) to effectively and assertively take action on climate change.

Hence, faced with the threat of all these negative environmental shocks, SIDS need to, somehow, learn not only to mitigate the effects of climate change and overcome their vulnerabilities, but do so at a faster rate compared to other countries, which, given their lack of resources does not mean an easy task. In fact, the Barbados Program of Action, adopted in 2004, recognizes "the difficulties they face in the pursuit of sustainable development are particularly severe and complex." United Nations (2004)

In this regard, it is also vital to stress that even though SIDS tend to be the group of countries more seriously threatened by climate change; northern developed countries are to blame for the current environmental devastation. Moreover, the present state of harmful environmental events indicates that the world has reached the end of a development and economic growth model based exclusively on fossil fuel energy, which began with the industrial revolution.

### 3.4.4. Overcoming Vulnerability and Building Resilience

Resilience may be defined as a country's capability to resist damaging impacts or, in other words, its ability to efficiently cope with negative shocks or hazards.

Hence, resilience is the ability to prevent the negative effects of vulnerability. Vulnerability and resilience are, therefore, the two sides of the same coin: if a country is highly vulnerable, it probably has low resilience, and vice-versa. It is indeed recognized that small developing countries in general and SIDS in particular, are more vulnerable than other countries, and, therefore, less resilient to external shocks. Resilience can be both inherent and nurtured, when

it results from what can be referred to as deliberate coping policies, purposely developed and implemented to manage and overcome vulnerabilities.

In the case of SIDS, due to their relative small size and limited human resource and natural constraints, the capacity to absorb the effects of hazardous events tends to be extremely lacking. For this reason, “the effects of hazards will be more pronounced and cause greater damage in SIDS." (Pereira 2005)

### 3.5. In Search for SIDS-Specific Special and Differential Treatment

In the multilateral arena, it is somewhat commonly accepted that special and differential treatment is vital for SIDS, given their particular vulnerabilities and structural inability to, autonomously, overcome negative shocks, build resilience and stimulate sustainable development. Therefore, SIDS are generally appreciated by the international community as having an economic disadvantage that deserves special attention.

According to Encontre (2004), there is, thus, “a legitimate question relating to the aim of promoting fair differentiation in the special treatment of developing countries, with particular reference to countries with highly vulnerable economies, such as SIDS." Encontre (2004) goes on, recapping that to some backers “of a more differentiated special treatment of SIDS, there ought to be a measurement of island-specific handicaps if the plea for special consideration and special treatment is to gain credibility, and if appropriate responses to these

handicaps are to be developed”. The concept of economic vulnerability has not been used as a working criterion to define the eligibility for special treatment in the area of ODA concession or in any other development area. In order to efficiently set up a link between special problems and adequate responses, and realize progress toward suitable international support measures, a prerequisite is that the recipients be systematically defined, on the basis of criteria which is not currently the case, given the lack of a globally accepted definition of SIDS.

Within the multilateral trading system, small WTO member states have made efforts to gain special concessions on grounds of smallness and vulnerability.

However, the acknowledgment of these constraints and of the special and differential treatment they should trigger within the framework of international cooperation has not been sustained by any significant move to define or measure, through criteria or threshold, who are vulnerable in the WTO. In the UN, the concept of vulnerability has been relatively well catered for.

As a matter of fact, the UN is the sole international organization that made vulnerability an operational criterion with direct implications for the treatment of relevant countries that is through the methodology for determining the list of LDCs, which is certainly beneficial for SIDS that are simultaneously LDCs, since this recognition will, in theory, allow the concession of various international benefits.

Although, for SIDS that are not LDCs, the recognition of development constraints imposed by being an Island State will have limited effect on how they are treated by the international community, since their SIDS condition alone will guarantee little special support. In summary, poor SIDS benefit from differential/special treatment only because of their LDC status, not as SIDS per se. The special handicaps of non- LDC SIDS are still not adequately addressed or accounted for, at least not explicitly in terms of support from the international community. SIDS have been supported by international partners essentially through "North-South arrangements such as those maintained by the European Union to benefit ACP countries, or by the United States in favour of specific regions involving island States (e.g. through the Caribbean Basin Initiative). This, in addition to the World Bank's small island exception and the EU-ACP Agreement.

This exception highlights the recognition, by the World Bank, that SIDS normally have to deal with higher transportation costs, fewer opportunities to practice economies of scale and strict human capital constraints because of their relative small size and small populations. Therefore, the small island economy exception permits the provision of IDA resources to small island economies, with per capita income above the operational cut-off for IDA eligibility, envisages special treatment for ACP countries that are SIDS), not much has been done to convert "the recognition of SIDS-specific issues into (…) SIDS-specific concessions, although this specificity has been advocated and sought by SIDS" (Encontre 2004). In short, the lack of an internationally agreed definition of the SIDS category has been the most

fundamental reason for which countries that claimed to fall in that category were not able to gain special treatment on grounds of being a small Island.

### 3.6. The Enigma for Islanders

The enigma lies in the fact that despite SIDS' many handicaps and vulnerabilities – particularly remoteness and insularity, environmental fragility, high dependence on foreign financing sources, lack of natural resources and economic constraints resulting from their small size – when compared to other countries, SIDS tend to perform relatively well in terms of economic growth performance, measured by per capita GDP.

In fact, according to UNCTAD (2002) "SIDS often appear relatively prosperous on the basis of the per capita income criterion (…). However, they are generally among the most economically handicapped and vulnerable countries, and for this reason, they are often among those least prepared to face the impact of graduation (…)"

In reality, SIDS' economic performance can be misleading in the sense that it 'covers up' some permanent structural handicaps that can seriously impede development in these countries. Therefore, a system of special and differential treatment based solely on income indicators may not be suitable. The Cotonou Agreement allows the implementation of specific measures benefiting landlocked and island ACP countries.

For SIDS given that eligibility for assistance does not account for the structural developmental impediments imposed by insularity, and, therefore, does not capture SIDS' real needs. The truth is that the relative prosperity of several SIDS is, mainly, explained by the growth of tourism (itself seasonal and of an unpredictable nature) and the increase in remittance inflows that, nonetheless, does not decrease their economic vulnerability nor induce major structural progress in these countries.

The Enigma tends to blind the international donor community, which sees the relatively high income level of SIDS and uses that as a definite yardstick to measure their economies and needs. This leads to the international donors shifting their attention from SIDS to other countries with lower income, though not necessarily more structurally handicapped. In effect, use of this 'traditional' yardstick make SIDS look more prosperous than they really are, which in turn leads to them being stripped off the assistance, privileges and concessions previously provided , the very crutches they need to sustain their momentum of growth.

Overall, the Enigma highlights the limitations and imperfections of the current special differential treatment of the LDC group by the donor countries, demonstrating that it is inadequate in its effort to address the particular issues of SIDS.

### 3.7. Other Special Classifications: Landlocked, Mountain, Post-Conflict

Aside from the LDCs, small developing States and SIDS, there are other countries in special situations. In this section, we will briefly mention four other examples, namely, landlocked developing countries (LLDCs), mountain countries, post-conflict countries and low-income countries under stress (LICUS).

Regarding LLDCs, it is important to note that "the lack of territorial access to the sea, aggravated by remoteness from world markets, and prohibitive transit costs (…) continue to impose serious constraints on export earnings, private Capital inflow and domestic resource mobilization (…) and, therefore, adversely affect their overall growth and socio-economic development" (United Nations 2006). Thus, being landlocked inflicts significant economic constraints on these countries, which, in turn, contribute to increased poverty and impacts negatively on development.

Notwithstanding technological improvements in transport, LLDCs continue to face structural challenges that greatly obstruct their access to world markets. Consequently, these countries often lag behind their maritime neighbours in overall development and especially through external trade, since higher transport costs substantially erodes the competitive edge of LLDCs. According to UNCTAD, LLDCs spend, on average, nearly twice more of their export revenue for the payment of transportation and insurance services than other developing countries, and three times as much more than the developed countries.

Among developing countries, LLDCs present "some of the poorest growth rates and are heavily dependent on a very limited number of commodities for their exports. As a matter of fact, of 31 LLDCs, 16 are classified as least developed” (United Nations 2006). The Almaty Programme of Action, agreed upon by the international community in 2003, sets priorities that, if implemented, are expected to reduce the costs faced by LLDCs, mainly due to their geographical condition, and help them attain sustainable development. "It showcases the political will and commitment of the international community to cater to the special needs of LLDCs.

Mountain developing countries constitute another important group, representing 26% of the Earth’s land and housing 12% of the world’s population."(United Nations, 2004). Moreover, this group is also a source of fresh water for almost half of humankind and important reserves of biodiversity, food, forests and minerals, which are being degraded due to “unsustainable agricultural practices and (…) inappropriate development." (United Nations, 2004)

Although, despite their economic potential (water resources and tourism), “most mountain regions are politically and economically marginalized and (…) mountain populations are at a clear disadvantage by comparison with other regions”. According to the United Nations (2004), “one half of the world’s approximately 700 million mountain inhabitants are vulnerable to food shortages and chronic malnutrition. Mountain people (…) suffer more than others from an unequal distribution of assets and from conflict."

International recognition of the development constraints dealt with by mountain countries initially took place at the Earth Summit, held in Rio de Janeiro, in 1992. In 2002, the Mountain Partnership was introduced during the World Summit on Sustainable Development (WSSD), held in Johannesburg. In 2003, the First Global Meeting of the Mountain Partnership took place in Merano, Italy. In 2004, at the Second Global Meeting of the Mountain Partnership, in Peru, the Cusco Plan of Action was adopted, aimed at, among others, providing a framework for effective collaboration in promoting sustainable mountain development. Note that some of these mountain countries (all members of the Mountain Partnership) are simultaneously part of other classes of special countries. (for example Turkey, Uganda, Ukraine, Venezuela.)

It culminated in an alliance, whose members include mountain countries, inter-governmental organizations and other major groups, with the goal of achieving sustainable mountain development. With this purpose in mind, the Mountain Partnership addresses the opportunities and challenges of mountain regions, in order to stimulate initiatives that will improve life quality in the mountainous regions.

In the case of post-conflict countries, promoting sustainable development is indeed a serious challenge given the particularities of war-torn societies, where long-term conditions of political instability obstruct the regular operation of economic system. According to Collier (2004), “unless the incidence of civil war is sharply reduced by international efforts a

substantial group of the poorest countries are likely to be stuck in a ‘conflict trap’ – a cycle of war and economic decline”.

Although, it is important to note that development policies in post conflict countries need to be adapted to specific circumstances, which differ greatly amongst post-conflict countries. In addition, development promotion policies, suitable to these countries, differ from those appropriate for equally poor countries that are not post-conflict.

Hence, for example service in the rebuilding of East Timor may only have limited applicability compared to the reconstruction of Afghanistan – two LDCs that also happen to be post-conflict countries. The international community through the UN Peace Building Commission, launched in October 2006, is trying to implement a larger degree of standardization into post-conflict involvements while differentiating them from other circumstances in which the state is failing.

Low-Income countries under stress (LICUS) – a class created in 2002 by the World Bank (WB), in an effort to improve aid effectiveness in these fragile countries – gathers countries characterized by very weak policies, institutions, and governance. The World Bank Task Force on LICUS stressed the fact that “aid does not work well in these environments because governments lack the capacity or inclination to use finance effectively for poverty reduction”. It identifies that neglecting such countries will, probably, prolong poverty and lead to their collapse, with detrimental regional and global consequences. The fact is that their fragility

does not allow them to adequately absorb development assistance. Moreover, because of their extremely challenging environments and poor performance, they often are also in danger of ultimately being abandoned by the international community, to the great detriment both of their suffering populations, the region and the wider world, which cannot afford a propagation of weak and failed states.

### 3.8. Chapter 3 in brief:

The formation of the LDC category was an attempt to structure aid concession to poor countries with a mutual set of development problems. In effect, a number of development support instruments have been established, aimed at assisting LDCs address structural handicaps. For small developing states and SIDS, handicaps are of a permanent nature particularly, the smallness of the territory, insularity, remoteness, etc., rendering them economically vulnerable. Moreover, today, these countries, particularly SIDS, face increased environmental challenges that endanger their very existence, which should justify international support measures intentionally aimed at minimizing island-specific vulnerabilities. With the same logic – i.e., systematization of international support targeted at countries with similar characteristics – other groups of countries have been recognized, namely LLDCs, mountain countries, post-conflict countries and LICUS.

# Chapter 4 (Part A)

## The Question of Graduation

As stated beforehand, being a member on the LDC list permits countries to benefit from special international support measures in response to their inherent disadvantages. The crucial purpose of LDCs and their development partners is to ensure that graduation from LDC status is rendered possible.

Part 1 and 2 of this chapter presents the definition of graduation, in this precise context, and the three graduation criteria validated by the UN and considered trustworthy indicators of the structural progress (or regress) undergone by LDCs. Part 3 raises some questions regarding the accuracy and reliability of the current graduation process, that is often regarded as, to some degree, far from reality.

In Part 4, the World Bank's definition of Middle-Income Countries (MICs) is highlighted, along with the key geographic, demographic and economic characteristics of these developing countries. Finally, Part 5 showcases the case of Botswana, a non-SIDS country to progress from LDC status.

### 4.1. Graduating from LDC Status

Graduation entails the loss of LDC-related advantages and special treatment, once the progress in the socio-economic performance of a country starts to set it apart from other LDCs. Graduation criteria are intended to reflect "the country's success in its development and its ability to achieve a favourable transformation of its economy," which is "attributable to a mix of sound domestic policies and propitious external conditions" (CDP 2004).

Hence, in 1990, the 2nd UN Conference on the Least Developed Countries (UNLDC) recognized, for the first time, the importance of allowing the LDC list to evolve, allowing the inclusion of countries and the graduation of LDCs that show "sufficient socio-economic progress to be able to pursue such progress in a less externally dependent manner"(UNCTAD 2002). The possibility of graduating from LDC status was initially raised in 1991, the year of the first major revision of the criteria for deciding the LDC list.

According to ECOSOC and UN General Assembly (UNGA) deliberations, "to become eligible for graduation a country must meet the thresholds for two of the three criteria; to qualify for graduation, it must do so in two consecutive triennial reviews."

An LDC will graduate six years after the CDP has recognized, for the first time, that the country met the criteria for graduation, and three years after the subsequent CDP triennial review, in which, because it met the criteria for the second consecutive time, it is found to qualify for graduation. During the 6-year period preceding effective graduation,

(i) UNCTAD is expected to prepare a vulnerability profile of the relevant country (in the period between eligibility and qualification for graduation), and

(ii) The graduating country, in close cooperation with international partners, is expected to develop (in the 3-year period immediately before effective graduation) a transition strategy, aimed at ensuring a smooth transition process.

In some cases, these profiles can help the CDP recognize that an immediate graduation can harm the country in its development process, given that it might not be structurally prepared to pursue socio-economic progress without the concessionary treatment associated with its LDC status.

There are two transition periods identified by the CDP:

(i) the pre-graduation transition period, so called because it "refers to the three-year period between a triennial review of the list that finds a country eligible for graduation and the subsequent triennial review when its qualification for graduation is confirmed by the Committee" (CDP 2004)

(ii) the post-graduation transition period, which takes effect "when the General Assembly endorses a recommendation made by the Economic and Social Council to graduate a country

from the list, on the basis of the Committee’s finding that it qualifies for graduation." (CDP 2004)

Concerning post-graduation transition, it is suggested that country-specific smooth transition strategies be devised (by both the graduating country and international partners), in order to “ensure that the graduated country continues to build on the progress achieved thus far."

Thus, “the primary aim of a smooth transition strategy relates to post-graduation support measures provided by the international community on the graduated country” (CDP 2004). In reality, being able to guarantee a smooth transition to an ex-LDC is generally very important, as graduating countries are most likely to continue to be dependent on international support.

The CDP is also expected to continue monitoring the development progress of graduated countries, with the support of the other relevant agencies, and also to report the countries’ progress and/or drawbacks to the ECOSOC.

## 4.2. The Three Graduation Criteria

The graduation rule is, in principle, quite similar to the rule for admitting new countries on the LDC list. Therefore, to be considered for graduation, a country must, in two consecutive triennial reviews, meet thresholds for at least two (2) of the following three (3) criteria:

(i) Per capita income level, measured by per capita gross national income (GNI)

(ii) Human capital development, measured by the Human Assets Index (HAI)

(iii) Economic vulnerability, measured by the Economic Vulnerability Index (EVI).

To be included to the LDC list, or to 'tumble back' into it, thresholds must be met for all of the three criteria.

Additionally, a graduating country is not only expected to surpass the thresholds under which LDCs are admitted into the category, but is expected to do so by significant margins: 20% for per capita GNI and 10% for HAI and EVI. These are considered ways of guaranteeing that unquestionable structural progress have occurred in the country.

### 4.2.1. Per Capita Income

The per capita income level criterion is measured through per capita GNI. Whereas, in order to be included on the LDC list, the per capita GNI threshold is set at less than US$ 750, a country is considered for graduation whenever it presents a 3-year average per capita GNI of US$ 900 or higher, based on a decision made by the CDP in its 2003 triennial review of the LDC list.

According to UNCTAD (2002), in prospective graduation cases, it is also crucial to pay attention to the role played by emigrants' remittances, external aid and other types of international financial transfers, with regard to their impact on GNI and on domestic productive capacity because these factors may 'disguise' the country's real per capita income, in the sense that, although economic indicators may be positive, structural improvements may not have occurred. This is to say that good economic performance may actually be influenced by elements such as remittances and aid, and not by positive structural changes in productive capacities, for example.

### 4.2.2. Human Capital

Human capital is measured by the Human Asset Index (HAI), which includes four equally-weighted indicators:

(i) Nutrition- deduced by the percentage of the population that is malnourished

(ii) Health- deduced by the under-five child mortality rate

(iii) Education- deduced by the gross secondary school enrolment ratio

(iv) the adult literacy rate.

As stated by the CDP, in order for a country to be accepted for inclusion on the LDC list, its HAI score must be 55 or under, whilst, on the other hand, the threshold for graduating under this index is fixed at 61.

### 4.2.3. Economic Vulnerability

Economic vulnerability is the relative risk to a country's development posed by exogenous threats and shocks, highlights the structural vulnerability of LDCs and is measured by an average of six indicators:

1) instability of agricultural production
2) instability of export earnings;
3) the economic importance of primary activities in GDP;
4) merchandise export concentration;
5) population size
6) the proportion of people displaced by natural disasters.

Under this Economic Vulnerability index, a country with an index score of 38 or higher is considered to be economically vulnerable, whilst for graduating, the index score will need to be 34 or lower.

## 4.3. Challenging LDC Exit Guiding Principles

The controversy surrounding the issue of graduation first arose when Vanuatu, in 1997, and Maldives, in 2000 – both SIDS – challenged the recommendation by the CDP by refusing that they both be graduated from the LDC group. Although they were both considered eligible for graduation (in theory ready to ‘stand’ by themselves), both countries did not feel prepared

enough to 'survive' without sufficient external support, based on their structural vulnerabilities. Consequently, the ECOSOC ceased to endorse the CDP's recommendation.

From 2002, many voices have called for reform of the graduation rule whereby all three graduation criteria (and not just two as is currently the case) must be attained for an LDC Country to be deemed eligible to graduate from the LDC category, so that no LDC member country with a low score under any of the three criterion is found eligible for graduation.

Apart from Botswana, all of the other countries found eligible for graduating from LDC status have been SIDS, although all with a high economic vulnerability index score – which highlights the flaws, pointed out by the "Island Enigma" discussed earlier. Moreover, apart from Tuvalu, all cases of possible graduation from LDC status are middle-income countries from the World Bank's point of view. The fact is that, for SIDS in particular, the EVI criterion (which has actually never been met by SIDS in CDP graduation assessments) is very important since their survival is greatly dependent on the indicators incorporated in this index.

When dealing with potential graduation prospects, some feel that a growing issue seems to be the issue of the importance that ought to be given to the vulnerability criterion. Whilst others take the view that vulnerability is neither less nor more important than the other criteria, thirdly, others argue that economic vulnerability should be regarded as a principal criterion, and this should have operational implications for the graduation rule.

Therefore, questions have been asked concerning the reliability of the current graduation criteria and process, frequently regarded as far from reality, given that the vulnerability criterion – so vital in appraising the real needs of island-countries – does not seem to be given adequate importance.

## 4.4 The figures Behind Middle-income Countries

As indicated by the World Bank, the group of middle-income countries (MICs) is made up of countries whose income per capita is between US$ 906 and US$ 11,115. Therefore, beginning from July 2007, the World Bank stated the existence of a total of 96 such countries, representing about 71% of developing countries in total.

It is vital to elucidate that these are not constant values given they are calculated using the World Bank Atlas method, which adopts the Atlas conversion factor, i.e., the mean of a country's exchange rate for a given year and its exchange rates for the two preceding years, calculating the difference between the rate of inflation in the country and that in the Euro Zone, Japan, the United Kingdom, and the United States.

Here including all low and middle-income countries, based on the World Bank classification, thus totalling 149 countries. US$ 906 and US$ 3,595 and upper-middle-income economies -a group made up of 41 countries with income per capita between US$ 3,596 and US$ 11,115. Similar to LDCs, in the UN, MICs are also found in the developing countries group. They are

still not fully developed economies; given their income level prevents them from exercising the economic autonomy of high-income countries. As a matter of fact, according to the World Bank, approximately 40% of the world's poorest people live in MICs.

Hence, MICs are dispersed across the whole of the developing world, although most of them are found in two regions: Latin America (comprising of 32%) and Europe and Central Asia (comprising 25%); in addition to these regions we can include, with fewer numbers, East Asia (comprising 16%) and North Africa and Middle East (comprising 15%). The amount found in Sub-Saharan Africa and Southern Asia is relatively small: 10% & 2% respectively. Moreover, the region with the greatest proportion of MICs "is, by far, Latin America: 79% of this region's countries are part of this income group", followed by North Africa and Middle East (with 67% of MICs), East Asia (with 43%) and Europe and Central Asia (with 42%) based on data from the World Bank.

**Table: Middle-income Countries at a Glance**

| | |
|---|---|
| Percentage of the World's Poor living in MICs | 40% |
| Percentage of the World's Poor living in MICs (excluding China and India) | 33% |
| Chance that a MIC is from Latin America or the Caribbean | 1 in 3 |
| Chance that a World Bank client country in the Middle East / North Africa is a MIC | 5 in 6 |
| Percentage of world's carbon emissions in MICs | 41% |
| Percentage of MIC population living in China | 43.5% |
| Percentage of MIC population living in the 25 smallest states | 0.3% |

Source: http://www.worldbank.org/ieg/mic/facts.html

Other noteworthy aspects regarding the geographical distribution and demographic balance of MICs, and their influence on the world economy, include the following:

- In Latin America and Sub-Saharan Africa there is an even distribution of lower middle and upper-middle-income sub-groups.
- Greater than 2/3 of MICs in East Asia, Middle East and North Africa, and Central Asia and Europe belong to the lower-middle-income sub-group. In South Asia all of the MICs belong to the lower-middle-income sub-group.
- From the 109 countries found in the tropics, 50 of them (45.8%) are MICs.
- Almost 85% of MICs have sea access, "a higher percentage than the world's average (79%) and very close to that of high income countries (89%)" according to the World Bank. Moreover, 23 out of the 98 MICs are islands or archipelagos (approximately 23%).

There is a great disparity in country size amongst MICs: there is a large group of small countries, with less than 2 million inhabitants, whilst five countries surpass 100 million inhabitants (one of them being China, with approximately 1.4 billion people; the other four are Russia, Brazil, Mexico and Indonesia). Almost half of the world's population lives in MICs. However, it is important to note the fact that the demographic load of China (approximately 20% of the world's population) is crucial in determining this high percentage.

Amongst MICs, lower-middle-income countries are more present in terms of demographic load (approximately 42% of the world's total); whilst the demographic load of upper-middle-income countries is significantly lower (approximately 5%). Once again, China's demographic load is responsible for this asymmetry. MICs contribute with approximately 35% to the world's GDP. Out of this figure, lower-middle-income countries contribute with 28% of the total and upper-middle-income countries with 7% of the total.

The MIC class is responsible for over 31% of world trade. Moreover, based on 2003 World Bank figures, approximately 24% of Foreign Direct Investment (FDI) is absorbed by these countries, as well as approximately 43% of bilateral ODA and roughly about 58% of emigrants' remittances.

Important conclusions can be deducted from the above figures, particularly that the percentage of remittances absorbed by MICs showcases the high emigration rates of these countries. Additionally, the significant ODA received by MICs- although donors are encouraged to solely focus their assistance on the poorest countries, particularly in Sub-Saharan Africa- indicates that, in the international co-operation arena, the MIC group is still relevant. Lastly, the importance of MICs in world trade and FDI gives the idea that amongst them are some of the most promising and dynamic markets from the developing world. Regardless, we should keep in mind that the different problems and development obstacles faced by the MICs varies greatly, and a 'one-size-fits-all' approach does not work.

## 4.5. Botswana: A Historical Example of Graduation from Non-SIDS LDC Status

Botswana, a small, landlocked, diamond-rich Southern African country, which gained its independence from the United Kingdom in 1966 and has been democratic since then – is one of the few countries to have effectively graduated from the LDC list, after being considered able and ready to do so back in 1994.

At present, Botswana is a successful upper-middle-income country, according to the World Bank, with a GDP per capita of USD 10.755, which represents an impressive growth, bearing in mind that, on the eve of Botswana's independence, its GNP per capita was approximately USD 50 and assistance from the Britain, its colonizer, accounted for almost 60% of the country's development budget. Being part of a region where the average country has been either poorer than at independence and/or in conflict and/or in socio-economic crisis, Botswana stands out as one of the very few countries in sub-Saharan Africa and Africa as a whole with both an impressive sustainable development achievements and political stability records. Botswana is also the region's longest democratic Country with good governance/state management accolades.

Botswana often referred to as the Switzerland of Africa, has been, over the last 30 years, "one of the fastest-growing countries in the world", particularly due to its "enviable record of economic achievement" as stated by OECD (2006). Botswana has been transformed from

being one of the poorest, most aid dependent countries to a middle-income country, no longer in need of substantial amounts of foreign assistance.

Remarkably, for a number of years in a row, Botswana has been classified as being the least corrupt country in Africa by Transparency International, with the highest sovereign credit rating on the whole continent.

On the other hand, Botswana is presently coping with significant, and possibly growth-hampering, development challenges brought on by persisting poverty (with 30% of its population living with less than US$ 1 a day), high unemployment -currently around 23%, high social inequality (having a Gini index of 63194, Botswana presents one of the world's highest inequality scores) and a high HIV/AIDS prevalence rate (with 38% of the population being infected, signifying one of the highest infection rates in the world). Botswana's economy is still highly dependent on mining activities (particularly diamond exports and some few other minerals), which accounts for approximately 35% of GDP, 90% of the Country's export earnings and over 45% of budget revenue. Diamond exports alone are responsible for approximately 80% of total export earnings, although the diamond industry only employs approximately 2% of formal sector employees.

Economic growth has slowed to 3.9% in 2013, from 5.7% in 2010/11 and around 8% in 2001, as opposed to the 1980-1990 period when Botswana recorded yearly economic growth rates of approximately 10%. Yet, Brautigam (2000) believes that "Botswana stands out as a

country that was once very poor, but that has managed its aid and its natural resources well, enabling it to graduate from most aid programs”.

As a matter of fact, in an attempt to seriously respond to development challenges and, subsequently, deal with the strong competition from the Republic of South Africa, the Government has introduced a strong national development plan, entitled the Vision 2016 Plan, a macroeconomic concept paper that puts forward broad goals for both economic growth and poverty reduction, through the implementation of reforms focused on diversifying manufacturing & production and exports away from primarily diamonds.

The 10$^{th}$ Plan (NDP10), which covers the period 2010-2016, “continues to stress macroeconomic stability and financial discipline as necessary conditions for long-term growth and poverty reduction” according to the OECD (2006). The efficient implementation of NDP10 is expected to increase economic diversification, lower dependence on the diamonds sector and increase employment in labour-intensive sectors, in a strong effort to tackle unemployment.

ODA has played a key role in enhancing economic growth and development, particularly during the time immediately after independence and, to a lesser extent, before its graduation. Brautigam (2000) notes further that “high levels of aid can work well to help a country graduate from aid dependence”. Botswana “began receiving aid during a period when governing institutions were weak, and used aid to build centralized, insulated government

institutions that then became critical for managing the aid relationships". It "relied on centralized strategic planning, combined with market-based growth strategies" and good governance.

The Government of Botswana now relies more on the private sector "as the engine of growth rather than nationalizing local and foreign firms", as indicated by the Commission for Africa (2005), and complemented by Bautigram (2000) who advocated that the Government of Botswana has "emphasized maximizing foreign exchange earnings, through well-negotiated deals with mining companies."

These good policies, perhaps due to the high quality of political leadership and good governance, highlights that the Country made good use of a period of high levels of aid to propel itself on a sustainable developmental track and, ultimately, was able to successfully manage economic crisis, namely the ones that struck most of the developing world in the late 1970's and early 1980's (Brautigram 2000), and, thus, maintain its middle-income status.

Moreover, despite its mineral wealth, Botswana has cautiously evaded the so-called 'natural resource curse' by adopting an institutional system solely based on meritocracy, rather than nepotistic practices conducive to rent-seeking behavior and generalized poverty. The success of Botswana is mainly explained by the quality of its institutions and the pragmatism of its political leaders, who understands the vital importance of being politically stable.

The World Economic Forum points out that Botswana, ranked 74th in the 2013 Global Competitiveness Index, "has succeeded in using its wealth from key natural resources to boost the growth rate." Key to Botswana's success have been its strong and credible institutions, the prudence in government spending and public trust in its politicians. The accountability and transparency in the Government has provided a stable macroeconomic platform, an efficient bureaucracy and market-friendly policies.

# Chapter 4 (Part B)

The key message that SIDS have been echoing in the international arena is that foreign aid is vital to ensure that the socio-economic gains made when they graduate from LDC to MIC is maintained so that the progress does not 'evaporate' because they suddenly find themselves without the support that they were used to. We have discussed earlier that SIDS have inherent challenges and because of these do need international support.

The second part of this Chapter will focus on Foreign aid. Firstly, to define foreign aid, then study foreign aid in a historical perspective. Thirdly, we will look at the trends in foreign aid and also ask ourselves whether foreign aid supports economic growth. Lastly, we will focus on foreign aid and SIDS, whilst looking at the latest developments.

## 4.6. Foreign aid

### 4.6.1. Definition of foreign aid

Foreign aid takes several different forms. The most pertinent with regards to its size and influence is called official aid. Official Development Assistance (ODA) is characterised as per the DAC (from the OECD) as "the total of grants and loans to aid recipients that:

(a) Are undertaken by the official sector of the donor country

(b) Have as the primary objective the promotion of economic development and social welfare in recipient countries

(c) Are on concessional financial terms (i.e., with a grant element equal to at least 25 percent of the total)."

OECD states further that "these financial transactions, technical cooperation costs are also accounted for in ODA; however, loans, grants, and credits for use by the military are not included. Transfer of payments to private individuals, public donations, foreign direct investment (FDI) commercial loans are not included (…)Assistance provided by non-governmental organizations (NGOs), which are considered to be foreign aid but not ODA, has increased very significantly in the past 25 years and now amounts to approximately one-third of official assistance."

The afore-mentioned definition shows that (as pointed out before) aid carries conditional strings with it. Often donor countries insist that recipients implement changes in political systems and/or economic policies that are more beneficial to the donors than recipients therefore; this limits the impact of the aid on the recipient country. Moreover, multilateral institutions also implement similar controversial tactics by imposing the conditions on recipient countries and calling them structural adjustment programmes.

Aid is provided for numerous reasons– for example, erecting infrastructure, increasing access to education, or responding to humanitarian emergency crises. It could also be the case that

aid may be provided mainly with a focus towards the interests of donors, or perhaps firms from donor countries, rather than the recipient countries. Based on a study of the patterns in apportionment of aid, McGillivray (2003) states that "past colonial linkages and political affiliations are key determinants of development aid and that these strategic factors are at least as vital as variables which highlight the needs of the recipient countries". Moreover, official aid flows have been dynamic. Various different motives have influenced aid relationships over a time period, as the global arena and dominant ideologies have changed.

### 4.6.2. The Beginnings of Foreign Aid

In its current formula, aid began late 1930s and scaled up tremendously during the aftermath of World War II. Europe was in ruins and had few economic activities happening to generate revenue to finance the re-building and restoration of buildings, roads, ports and other infrastructure destroyed during the war. The American government proposed what was called the European Recovery Program, commonly called The Marshall Plan. Under the plan, two to three percent of its budget (at the peak of the programme) was dedicated towards helping Europe get back on its feet. This is significant amount when compared to the level of assistance the American government makes available currently. The Marshall Plan, looked after by what was then known as the Organisation of European Economic Co-operation (now succeeded by the OECD) was heralded as a success story.

It is important to note the differences between Europe after the Second World War and developing countries that have been receiving foreign aid for the past forty years. As a result of the Second World War, Europe practically, lacked physical capital. The war had killed a great many highly skilled people, damaged lots of institutions, and made institutional change compulsory. Regardless, not all was lost. Europe still had a quite a significant number of highly skilled people and some institutional frameworks were more or less intact. However this is not necessarily the case with SIDS.

Additionally, the times before the war, Europe had made impressive technological advancements and this carried over during and even after the war. Therefore, only funding was needed as a catalyst for its re-construction. This is where the Marshall Plan came in. Therefore foreign aid was seen in a positive light and there was much hype around it and its potential future efficacy.

As a result of what was achieved, the developed nations believed that the same formula would apply to the LDCs thus spurring development and growth to ultimately eradicate poverty. This policy was popular in the 1950s and 1960s as the popular view was that there would be a trickle-down effect from European colonisers to their recently independent proxies.

Furthermore the new trend cropped up in the 50s whereby funds from aid were used to implement projects and provide technical assistance linked to these projects.

The multilateralism aspect of foreign aid gained prominence during the late 1970s.

Many favoured multilateral aid as opposed to bilateral because it was viewed as more effective with less conditions carried by bilateral aid. Therefore international multilateral organisations capitalised on this opportunity to increase their presence significantly.

The 1970s period witnessed a shift towards the recognition of the importance of job creation, equal distribution of income and the reduction in poverty level as important outcomes of foreign aid. The experience of Europe was not necessarily applicable to the developing world and newer policies such as 'basic human needs' and 'redistribution with growth' came to the fore. Notwithstanding, the project aid approach still persisted.

The oil crisis in 1979 altered the economic landscape and caused a spike in oil prices resulting in the international debt crisis. This reversed the fortunes experienced during the sixties and seventies. Developing countries could not manage to balance revenues gained from exports with the loss in revenue compounded by high interest rates from imports. The governments' priorities had to be re-aligned to ensure balance in their account books and address failed domestic strategies. It was now believed that development should be spurred by trade as opposed to foreign aid.

With the approach of the 1980s, widespread opposition towards the influence or involvement of the government in the economy became more apparent. The proponents were calling for less government intervention so that the forces of demand and supply could regulate the

market. Furthermore the increased role of the private sector, including NGOs, was promoted by the World Bank and other multilateral agencies. At the same time, poverty alleviation took a back seat in mainstream agendas for economic reform.

Bilateral aid donors and multilateral agencies faced challenges in channelling resources to the developing Countries. Quick-disbursing macroeconomic programme assistance, under World Bank and IMF intervention programmes became the norm. This was overlooked by those opposing flow of aid and a new trend of funding programme aid and loans for adjustment to governments emerged.

The reduced role of the government in the economy and the subsequent increased involvement of the World Bank and IMF meant that there was also an increase in strings attached to the funding. A situation which was popular amongst the proponents against aid, given that the conditions were mostly asking for economic reforms and perhaps, or debatably, calling for implementation of good policies.

At the turn of the 1990s, several factors had provoked doubt as to the positive influence foreign aid could have. Such factors were according to the UN (Finn Tarp, Date n/a)

“(i) The continuous persistence of economic crises in most of the developing Countries

(ii) Geo-political shifts following the end of the Cold War, which weakened relationships between the developing countries and former colonial countries

(iii) The mainstream belief that policy linkages were failing to promote genuine policy reform

(iv) A rising fear that aid was producing undesirable dependency relationships between donor and recipient"

In consequence, a combination of these factors meant that there was much less backing for aid in the developed countries. In addition cases of corruption and the lack of transparency in the developing countries gave rise to further opposition and criticism towards the provision of aid.

However, by the turn of the new millennium foreign aid was re-introduced on the agendas of the international community. An agreement was reached amongst governments of developed countries that a fresh approach towards development assistance, which prevented past mistakes, was required.

This came partly, from the acknowledgement of the rising magnitude in global interdependency, or otherwise known as globalization, meaning that poverty and crisis in one part of the world may have implications for the rest of the world. These perceptions gave birth to the Millennium Development Goals (MDGs), aimed solely at reducing poverty and dealing with basic needs of human such as access to health, education, and potable water. Sub-Saharan Africa was given a lot of focus.

### 4.6.3. Trends in Foreign Aid

As mentioned above, based on changes in views and perceptions, the volume of aid has been fluctuating through the years. Aid flow was on an upward trend from the fifties up to the late eighties and very early nineties. Conversely, after 1992 the trend was reversed up to the beginning of the year 2000.Thereafter, the flow of aid has increased steadily once more, though not at the pre 1990s rate nor at the rate promised by donor governments nor at the level required to attain the MDGs.

As a result of rapid population growth, private flows increased significantly until the recent financial and economic crisis that affected much of the Developed World.

Moreover, aid is very important to the developing countries, it adds another dimension to the revenue collected by the government through taxes, through revenues collected from FDI (and other ensuing benefits FDI brings), and also through the money collected from relatives abroad through remittances. It is important to note that this is not the case in all developing countries. Perhaps foreign aid is even more important in the poorest countries because the aid funds are used to buy food and other basic necessities because they do not have the necessary basic infrastructure and institutions to capitalise on the other forms of revenue collection.

## 4. Does foreign aid support economic growth?

Although the question seems to be simple, it is definitely not an easy one to answer. This emanates from methodological challenges, and the fact that data is lacking and those available are not always reliable. In order to effectively calculate the effect of foreign aid, one has to, as advised by the UN (Finn Tarp, date n/a)

“compare the values of an identified indicator, being growth in this case, in two strictly independent cases, both with and without foreign aid. To determine the ‘real’ measure of aid impact, the importance of all other factors that have influenced growth in a specific country over a time-frame must be carefully accounted for. “

Given that we do not simultaneously measure the same country; receiving aid and not receiving aid, the key evaluation challenge thus, is to compare what really happened with a reliable counterfactual.

There is no reliable way to address this issue without coming up with assumptions that will definitely be up for debate, both theoretically and in practice. Therefore, it can safely be said the impact of aid remains a grey area.

### 4.7. SIDS and AID – Relevant Concerns

SIDS face numerous limitations beginning with their physical size. They are also vulnerable as their narrow resource base prevents them from being able to generate economies of scale.

SIDS have small domestic markets and also depend heavily on few external and remote markets to sell their goods. They often face many barriers such as higher expenditures for energy, transportation, infrastructure, communication and servicing, as a result of being far from the main export markets and from the main ports from which they import their goods. On top of all that, SIDS are also vulnerable to natural disaster, this means that much damages to infrastructure are caused when these natural phenomenon occur, the 2004 Tsunami in the Indian Ocean being proof of that.

For this reason, foreign aid is very important to SIDS because it provides funding for schools, hospitals, roads, airports, ports, sport venues etc… which are all damaged during natural disasters. Therefore because of these vulnerabilities the foreign aid makes a big difference and is critically important for SIDS.

For this reason and based on the calls made by SIDS in the international forums, the 1994 SIDS meeting held in Barbados resulted in overwhelming support and many promises of financial assistance for SIDS. Although, it is important to point out that the promises were not kept and limited financial assistance to SIDS have actually been provided. The OECD- DAC has observed that "the level of aid to SIDS dropped by over 50% between 1994-2004"

Nevertheless SIDS still fare better in relation to aid received per capita than their landlocked developing countries counterparts. To quote the OECD-DAC "from 1995 to 1999 aid to the

Pacific region was $220 per capita and $34 per capita to the Caribbean. These figures surpass aid per capita to Sub Saharan Africa at $22 per capita, Latin America ($10) and India ($2)."

To note, this disparity may be explained by the great costs that comes with implementing aid programmes in remote and dispersed islands where the population is often small in numbers. It must be said though that this also speaks as to growing importance of SIDS in the geo-political and strategic sphere.

Despite the above, funding for SIDS are not channelled on an equal basis, even though the funding is a major portion of the budget for all SIDS governments. In a few SIDS, the proportion of aid amounts to the same figure and sometimes surpasses their GDP. On the other hand where SIDs governments over-rely on foreign aid, this can have negative consequences, such as these recipient becoming more answerable to donor governments as opposed to their own electorates, becoming less accountable and leading to corrupt practices and ultimately becoming complacent and refusing to engage in reforms to address weak institutions and policies that have proven unsuccessful. Another concern is that SIDS are exposed to aid flow that is not stable and/or consistent as they change at the whims of the donors and their ever-changing agendas.

On the flip side, some SIDS are unfortunate in that they do not obtain aid at a level sufficient to sustain their economies and to provide necessities to their peoples such as hospitals, schools, roads etc… In addition to poor governance and conflict, some countries'

development endeavours are even regressing. In Vanuatu and the Solomon Islands, for example, " levels of income poverty were much greater in 2001 than 1990. In P.N Guinea, the percentage of undernourished people out of the total population increased to almost 30% during the 1990s." according to UNDP (2003).

Thus, it can be said that aid in relation to SIDS is a bit of a paradox: sometimes plentiful and yet sometimes, thoroughly inadequate.

## 4.8 Latest Developments

### 4.8.1. Reducing the list of MIC aid recipients

Recent developments indicate that donor members from the OECD are thinking about halting aid flows going towards several middle income countries. The justification for this is that the funds being channelled to these MICs could and should be going to the poorer countries that apparently need it more.

The OECD's development assistance committee is currently undertaking sector-wide discussions on the way forward when it comes to providing foreign aid. The OECD has the period after the target set for attaining the MDGs in mind. Discussions are focussing on, according to the OECD-DAC "countries with a per-capita national income above $7,115 (£4,284) (…) would be taken off from the list of eligible aid recipients." Should this proposal be adopted, OECD-DAC have assessed that this would entail "the end of official aid to more

than a dozen countries including Venezuela, Mexico, Gabon and the Seychelles islands, with several more eliminated from the list in coming years."

Under the current format, countries come off the list when income per-capita surpasses $12,616. An alternative solution proposed in Paris in March, earlier this year, and one that perhaps the donor governments would be more amenable to, is the introduction of funding limits and also a mechanism to identify the amount of aid reaching those countries in need, as opposed to simply crossing a few out of the group.

Concord (2014), advises that, "any decision taken on aid spending should not be taken on the basis of countries' income levels alone." He emphasised that "Poor people matter wherever they live," and elaborated further in his statement to the OECD-DAC that " poor people living in middle-income countries cannot be left behind, and a revised DAC recipient list cannot assume that their governments will be willing and able to deal with eradicating poverty, fight[ing] against inequality and adaptation towards a more sustainable development."

Importantly, he eloquently added that "A country's income status is not sufficient to give a true and accurate picture of its population's living conditions. Other indicators, such as development, inequality and vulnerability criteria, should be brought into the calculations,"

Richard Manning (2014), the former head of the DAC, agreeing with Concord, advocated, “some paring down of the aid recipient list could be a good idea, but should be handled with caution.”

He warned further that no one is completely safe from climate change and other natural disaster, as he put it "To totally disincentivise flows of assistance to these places wouldn't be a very smart move; you'd have to look at that"

OECD ministers will meet in Paris in December 2014 to consider the final proposals. Any of the changes agreed will begin applying to aid flows from 2016. Whilst some developing countries, including SIDS, are fortunate enough or have laid down the proper foundation to benefit from foreign aid or FDI and remittances, this is not the case for all SIDS and other developing countries as they need the external funding to purchase basic necessities such as food.

### 4.9 Chapter 4 in brief:

In a versatile international arena, the implementation of LDC-related support measures could have accelerated or increased progress in LDCs, assisting them to overcome development challenges and, subsequently, graduate from LDC status, as based on UN rules.

Yet, others have questioned the practicality of these rules, considered somewhat not in touch with reality. Almost all of the graduation cases so far have been SIDS, and despite their inherent economic vulnerabilities, the EVI criterion seems to have not been given sufficient importance in the graduation process. Botswana, a landlocked Country, is one of the few non-SIDS countries that have ever graduated from LDC status.

Foreign aid is a controversial issue which has been debated at great length. Seen as successful at first, it is quite obvious that foreign aid has many sceptics who believe that the aid is creating dependence and also donor countries have ulterior motives tied to the aid provided. For SIDS, the struggle to 'convince' the international community that aid is essential to maintain progress remains. Perhaps one of the biggest challenges is still to come, as we wait to see whether the OECD implements the proposal to remove countries from the list of upper-MICs receiving aid. What is certain is that this is not a good sign for the SIDS cause.

## Chapter 5

### 5.0 Case Study: Maldives graduation process

This chapter will look at the Maldives Islands as a case study of a recent SIDS that has graduated from LDC to MIC status. We will first look at the historical & political background of Maldives to gain some context and perspective. Then we'll observe the economic outlook of Maldives; and subsequently analyse the graduation process and the implications for Maldives.

### 5.1 Historical & Political Background

The Maldives Islands was a sultanate until the 12th Century, and became a British protectorate in the year 1887. Maldives became a republic in 1968, three years after gaining independence. Former President Maumoon Abdul Gayoom controlled the islands' political scene for over 30 years, and was elected to six successive mandates by single-party referendums. After political protests in the capital Male in August 2003, President Gayoom and his Government promised to embark upon a process of democratic reforms, including a more representative political system and increased political freedoms. Progress was slow, and many of the pledges were slow to be realized. Regardless, political parties were permitted in 2005. In June of 2008, a constituent assembly – known as the "Special Majlis" -wrote a new constitution, which was approved and ratified by President Gayoom in August of 2008. The first-ever multi-party Presidential election was held in October 2008. Gayoom lost the elections in a run-off poll by Mohamed Nasheed. In early February 2012, President Nasheed

resigned from the office of the Presidency and handed over power to his Vice-President Mohammed WAHEED. To note, Maldivian officials have played an important role in international climate change negotiations, because of the Maldives' low elevation and the ever-present threat from sea-level rise, on the United Nations Council for Human Rights and in various other international negotiations.

### 5.2 Economic Outlook

Tourism is the Maldives' primary economic activity, and accounts for almost 30% of its GDP and over 60% of foreign exchange receipts. Fishing is the second biggest sector; however, fish catch has significantly declined in recent years. The agricultural and manufacturing sectors plays a smaller role in the economy, restricted by the limited availability of land for cultivation and limited availability of domestic labour.

A sharp decrease in tourist arrivals and fisheries exports, complimented by increased Government spending on social welfare, subsidies, and salaries of civil servants have contributed to an immense balance of payments deficit, which was temporarily appeased by a $79.3 million IMF Stand-By arrangement. Yet, after the first two payments, the IMF halted subsequent payments because of concerns over the country’s increasing budgetary deficit, and the Government had to resort to seeking alternative sources of budgetary support. Diversification of the economy beyond tourism and fisheries, reforming public finance spending, creating employment opportunities for the youth, and alleviating corruption, and

increasing drug problem are some of the challenges the Government is faced with. In the long term, Maldivian authorities need to face the impact of erosion and global warming on their low-lying islands; with 80% of the land being one metre or less above sea level.

### 5.3 The Graduation process for Maldives

The Maldives graduated from the LDC status on 1st January 2011. The graduation process became finalised after a longer than normal transition period. The CDP identified that the Maldives met the graduation eligibility criteria for two consecutive triennial reviews of the group of the LDCs (both in 2001 and 2004) on the merits of its high GNI per capita and Human Asset Index (HAI) and made a recommendation for the Maldives graduation to MIC status to the Council in 2004. The recommendation was approved by the Council and the General Assembly took note of this decision. Graduation of the Maldives to MIC status was initially scheduled to be finalised three (3) years after its adoption by the General Assembly, on 20th December 2007. However, as a result of the catastrophe caused by the tsunami of 26 December 2004 in the Indian Ocean, the General Assembly decided to push-back the beginning of the three year period after graduation to 1st January 2008, therefore, postponing the Maldives' graduation to MIC status to 1st January 2011.

### 5.3.1 Development progress of the Maldives since graduating to MIC

### 5.3.2 Maldives and the LDC criteria

The mean GNI per capita of the Maldives for the time period 2008-2010 was $5,473 – which was approximately five times over the income graduation threshold for graduation. As a matter of fact, the gap between the Maldives' income and the graduation threshold became wider since the last review by the CDP when the Maldives' per capita income was approximately 3.7 times over the graduation threshold. The Maldives is categorised as an upper middle-income country status by the World Bank.

The HAI of the Maldives is high at an index of 92, which is significantly above the graduation threshold index of 66 established for the 2012 review by the CDP. In comparison to 130 other developing countries, the Maldives has the 32nd highest HAI index. Moreover, the Maldives has achieved 5 out of the 8 MDGs prior to the 2015 deadline, meaning that the Maldives is the only MDG plus country from South Asia. These remarkable achievements reflect the implementation of effective and sound policies, further complimented by support from the international community; and the Governments' commitment to social welfare of its citizens. Meanwhile, progress is still required with regards to attaining the MDGs on gender equality and women's empowerment, and also ensuring environmental sustainability.

The structural economic vulnerability remains a challenge for the Maldives as reflected by its high economic vulnerability index (EVI). The Maldives is the eleventh on the EVI amongst a group containing 130 developing countries, particularly based on the fact that the country's

high exposure to external shocks, as a result, of its small population size,(approximately 320,000) with all of the population living in very low elevated coastal zones and a high concentration in exports.

### 5.3.4. Macroeconomic developments of the Maldives

Since the Maldives was nominated for graduation in 2004, its GDP has kept on growing, regardless of two major exogenous shocks. In December of 2004, the Maldives was impacted by a tsunami that was caused by an earthquake off the coast of Indonesia. The tsunami killed a total of 108 Maldivians, and approximately 12,000 of Maldivians were displaced. The tsunami also caused $400 million worth of property damage, or the equivalent of 40 % of the Maldives GDP in 2004. Consequently, the Maldives GDP per capita decreased by 11.3 per cent in 2005.

Moreover, as a direct result of the world financial crisis in 2008, less tourists visited the Maldives, this negatively affected the tourism industry - the primary sector in the island economy.

As a result of an assessment carried out by the CDP, the economy of the Maldives contracted by 4.7% in 2009. Its economy recovered in 2010, recording a growth rate of 9.9 %, mainly driven by tourism. Regardless of the positive economic developments, the Maldives still faced double deficits in both the external and fiscal fronts. The current account deficit decreased slightly in 2009, resulting from the recession in that year, but increased since then. The

widening deficit mirrors higher international commodity prices, in addition to greater import demand, caused by the economic recovery in 2010, which balanced out the positive effects that the rebound in tourism numbers had on the country's revenue.

The fiscal deficit amounted to 23.3% of the Maldives GDP in 2009, primarily due to diversified fiscal policies to address the depressed domestic demand but subsequently fell to 12.8 % of GDP in 2011, as a result, of the fiscal corrective measures, recommended by the IMF. The IMF supported programme recommended fiscal adjustments to improve the Maldive's fiscal sustainability. It included reforms in the tax system, decreases in wages of civil servants, increases in electricity tariffs and subsidy reduction.

### 5.3.5 Relations with development and trading partners

Losing its LDC status meant a gradual phasing out of LDC-related international support to the Maldives, such benefits as preferential market access priority, ODA allocation and special eligibility for financial and technical assistance.

Anticipating the need to adapt to the changes in development and international partners' support, the UN Economic and Social Commission for Asia and the Pacific (UNESCAP) and the United Nations Trade and Development Conference (UNCTAD) proposed to the Government of the Maldives to adopt some "smooth transition policies" to avoid possible obstacles in its development endeavours. Consequently, the Maldives Donor Forum was held

on 28th to 29th March 2010, whereby the Government of the Maldives presented the challenges and obstacles it faces and the measures it has proposed to counter them to its international development partners.

The government also presented five development priority areas – macroeconomic reform, reform of the public sector, social development, governance and climate change-that needs external support to ensure positive achievements. Consequently, the international partners have adopted some provisions to phase out some of the LDC-specific support initiatives, as follows:

- At the request of the Maldives, the United Nations General Assembly adopted resolution A/65/L.66/Rev.1/Add.1, which extended travel-related benefits, if it was requested by the graduate country for a time frame related to the development status of the country in question but in any case would not go beyond 3 year period.
- In July of 2010, the Board of the IDA (EIF) advocated that those which had graduated could have access to full benefits of Enhanced Integrated Framework for a time period of three years and an additional extension of two years may be requested by the country. Under EIF fund, the Maldives submitted two project proposals for approval; (1) the partial privatization of the international airport in the capital city Male and (2) for the development of its custom services. The Board of EIF approved the second project to establish a trade information system, upgrading the Maldives' Advanced System for Custom Data (ASYCUDA), and also supported its services

negotiations in the South Asian Association for Regional Cooperation (SAARC) and WTO.

- The European Union (EU) grants at least a 3-year extension on duty-free, quota-free access to the EU market area under the Everything-But-Arms Initiative. The Maldives gained access to the EU markets until the end of 2013.
- Japan is a traditional exception to the trend of providing smooth transition benefits. Japan applies the GSP tariff rate of 3.5% to tuna imports from the Maldives, whilst the same imports used to enter the Japanese market at 0% tariff rates. Yet, based on latest data available, exports of the Maldives to Japan does not seem to have been significantly negatively affected by the loss of LDC status.
- Total ODA allocated to the Maldives reached $51 million in 2009, of which $31 million was in the form of grants. The European Union and Japan were the two largest donors in 2009. Social infrastructure has been receiving the biggest share of total ODA allocated during the first decade of the new millennium, with exception in 2005 when international donors increased humanitarian aid after the tsunami catastrophe.

Based on the results of a survey carried out by the Secretariat of the CDP, numerous official donors indicated that they would not change their policy stance towards the Maldives after graduating. Some donors stated that any changes introduced in their assistance to the country would only reflect the priorities of the smooth transition strategy devised by the government of the Maldives. In the case of Japan, for example, ODA had been directed on social

development and social infrastructure, particularly education, health care and community development, before the Maldives graduated, whilst after graduation Japan's ODA focused on climate-change mitigation and technical cooperation, being a few of the priorities identified by the Maldives Government.

Meanwhile other international donors foresaw no immediate reductions in ODA allocation and technical assistance. In this context, some UN agencies, such as UNEP and UNFPA, advocated that they would keep pre-graduation objectives and policies towards the Maldives after its graduation until the end of 2015.

The Maldives has been pro-active in engaging the international donors in continuing to provide assistance. In this context, the Government has been vital in enabling the phasing out of travel benefits previously offered by the United Nations and in guaranteeing assistance for a smooth transition out of the LDC status.

Regardless, it is still too early to draw any decisive conclusion on the impacts of graduation on the development of the Maldives due to the very short post-graduation period. Jeffrey Waheed, a diplomat from the Permanent Mission of Maldives to the UN concludes it best by stating, " the loss of LDC benefits have been mitigated in some sectors such as trade, but have been detrimental in others such as developmental assistance and its effects on our fiscal policies."

# Conclusion

The United Nations has declared 2014 as the International year of Small Island Developing States. This has generated a lot of enthusiasm and buzz amongst the islanders. To compliment this, an international conference on Small Island Developing States will be held in Samoa, September of 2014. A lot of work, through numerous meetings, has been done to prepare for this auspicious event. The Pacific Island Countries, the CARICOM and the AIMS region have all held preparatory meetings. For SIDS, the feeling is that they are finally getting the world's attention towards their cause; the world is finally listening to their message.

The message all along has been that (as discussed above) SIDS have many handicaps and vulnerabilities. These include: remoteness and insularity, environmental fragility, high dependence on foreign financing sources, lack of natural resources and economic constraints, all resulting from their small size. When compared to other countries, SIDS tend to perform relatively well in terms of economic growth performance, measured by GDP per capita. In reality, SIDS' economic performance can be misleading in the sense that it hides some permanent structural handicaps that can seriously impede development in these countries.

For SIDS, the GDP per capita does not account for the structural developmental impediments imposed by insularity, and therefore will not capture the real needs of SIDS. In actual fact, the relative prosperity of most SIDS are, mainly, explained by the growth of tourism and the

increase in remittance inflows that, does not address their economic vulnerability nor induce major structural progress in these countries.

The international donor community sees the relatively high income level of SIDS and shifts its attention from SIDS to other countries with lower income, though not necessarily more structurally handicapped. This is compounded further by the fact that the graduation of SIDS to MIC status requires that the Country meets the thresholds for at least two of the three criteria: per capita gross national income, Human Assets Index (HAI) and the Economic Vulnerability Index (EVI), with the EVI often overlooked.

This paper has comprehensively explored this topic and has shown that the Thesis Statement has its merits.

As Mr. Jean-Paul Adam, the Seychelles Foreign Minister succinctly puts it:

"SIDS are the victims of their own success."

# Recommendations

From research carried out, this paper proposes some recommendations to address this situation, as follows:

(i) SIDS must first and foremost identify a commonly accepted definition of what constitutes a Small Island State. Currently, different organisations/agencies have different definitions of Small Island States and each of the organisations have different parameters for membership. Therefore, it is difficult for donors to effectively identify recipients, as it is not clear which countries are Small Island States

(ii) The UN considers reforming the graduation process, by giving equal weight to all three graduation criteria. In theory, this should avoid circumstances where countries graduate to MIC status when they are not ready to do so, and they will keep on receiving ODA under LDC status and only graduate when they are truly ready to do so.

(iii) The CDP carries 'on the ground' evaluations of socio-economic development and performance of countries being considered for graduation. CDP members would be in the field, in other words, live in the particular country for a period of time and truly obtain first-hand experience of the economic situation in the respective country, as opposed to relying on reports or data provided by Governments or NGOs. This means that the CDP may identify institutional

weaknesses and advise accordingly to ensure that the respective country is ready for graduation.

(iv) For SIDS that have already graduated, it is recommended that they obtain, at the minimum, access to concessional loans for infrastructural projects. Whilst it is a fact that the GDP per capita is relatively high in SIDS, the Cost per capita, in other words, the cost of constructing infrastructure is relatively higher in SIDS given the lower scale and size of the economy, scarce labour resources amongst others than it would be in bigger countries. SIDS cannot build smaller infrastructure in terms of ports and airports as they have to abide to international safety standards.

(v) The UN considers creating a sub-category for SIDS, under the MIC status, where the SIDS keep on having access to the benefits that they were previously having as LDC, this based on their inherent vulnerabilities to external shocks for example, the Tsunami that affected the Maldives, the earthquake in the Haiti, flash floods in the Seychelles, to name a few.

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