UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
UNCTAD

Achieving Graduation with Momentum through the Development of Productive Capacities

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

Achieving Graduation with Momentum through the Development of Productive Capacities

Geneva, 2021

This publication has been edited externally.

United Nations publication issued by the United Nations Conference on Trade and Development.

UNCTAD/ALDC/2021/4

eISBN: 978-92-1-000086-4

Acknowledgements

The work was completed under the overall supervision of Paul Akiwumi, Director, Division for Africa, Least Developed Countries and Special Programmes at UNCTAD.

Lisa Borgatti coordinated the publication's process and provided substantive inputs. Taffere Tesfachew, a consultant of the Division for Africa, Least Developed Countries and Special Programmes, drafted the text. Comments received from Mussie Delelegn, Patrick Osakwe and Rolf Traeger are gratefully acknowledged.

Mark Bloch edited the text.

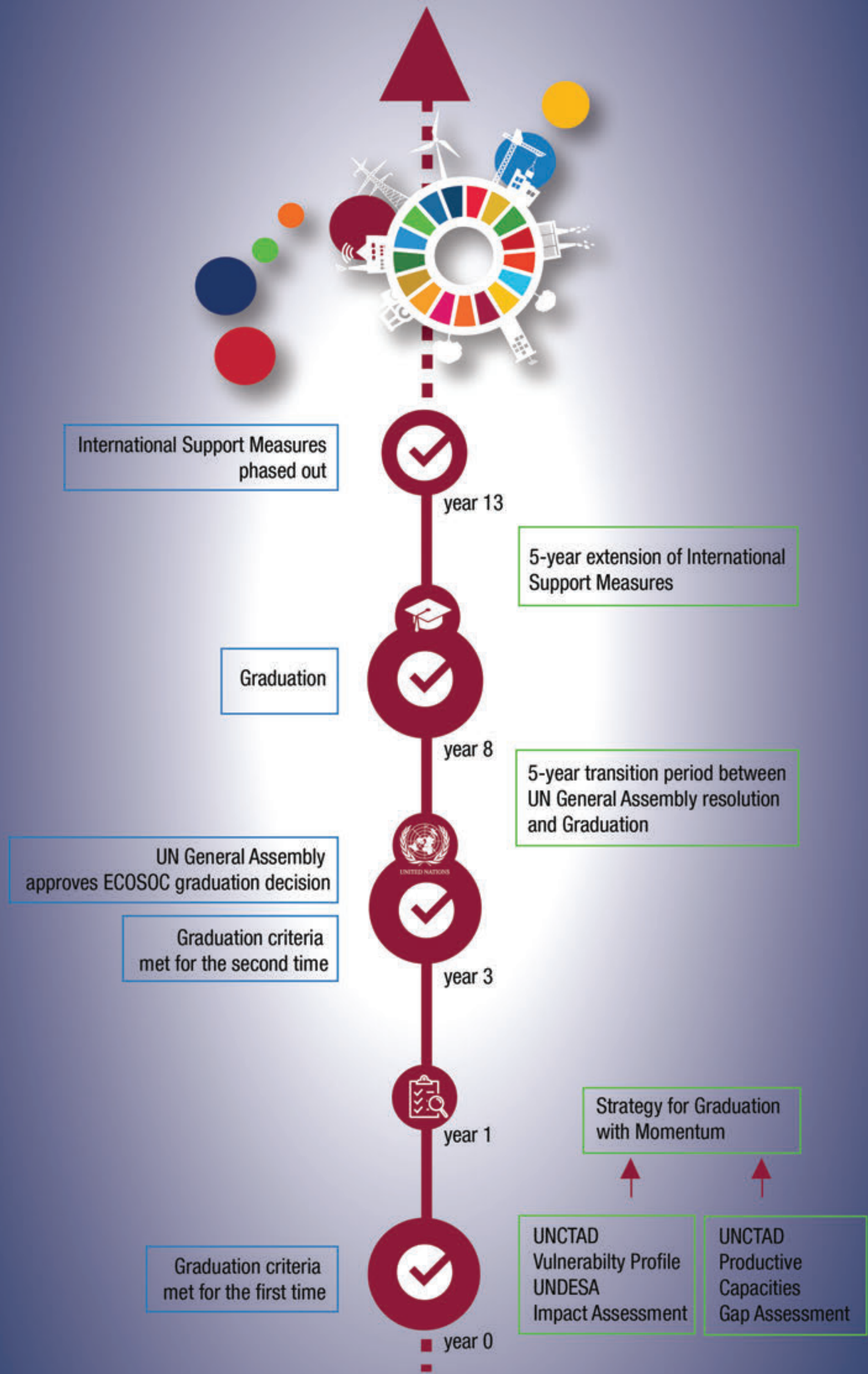
The cover design was prepared by Stefanie Garry. Rostand Ngadjie Siani was responsible for the layout and desktop publishing.

Contents

Abbreviations

CDP	Committee for Development Policy
EBA	Everything But Arms
EIF	Enhanced Integrated Framework
HAI	Human Assets Index
EU	European Union
EVI	Economic and Environmental Vulnerability Index
GVCs	Global Value Chains
IPoA	The 2011 Istanbul Programme of Action
ISMs	International Support Mechanisms
LDC	Least Developed Country
ODCs	Other Developing Countries
PCGA	Productive Capacity Gap Assessment
PCI	Productive Capacities Index
SGM	Strategy for Graduation with Momentum
SDT	Special and Differential Treatment
UNGA	United Nations General Assembly
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Timeline for Graduation with Momentum



Executive Summary

The development path a least developed country (LDC) follows to achieve the eligibility criteria for graduation has important implications for the challenges and vulnerabilities they face after graduation, as well as the means they have at their disposal to address them. The dynamics that drive LDCs to achieve graduation also impacts their performance on graduation. UNCTAD maintains that a country's development process continues indefinitely beyond graduation, and its subsequent success critically depends on the foundations it was able to build during graduation. How graduation is achieved is thus as important as when it is achieved.

In most cases, the challenges that countries face in the post-graduation period are a continuation of those they faced prior to graduation. The weaknesses and impediments that characterized their economies in the period prior to graduation, e.g. underdeveloped productive capacities, lack of dynamic enterprises and infrastructure, limited technological capabilities, and infant or fragile institutions, will continue following graduation. Productive capacities are defined as the diverse competencies, resources, skills, infrastructure, technological capabilities, institutions and knowledge systems, a country needs to produce and deliver progressively more sophisticated goods and services in an efficient and competitive manner. If some or all of these essential elements of productive capacities are not developed before graduation, it is highly likely that the road to sustainable development after graduation will be rough and full of pitfalls.

Graduating LDCs need a new strategy to enable them to achieve graduation on a sustainable basis, and with an economic and developmental base for continued development, or 'graduation with momentum'. The key feature of this graduation strategy is to bridge the pre- and post-graduation development processes to create sustainable graduation and continuity in the development trajectory beyond graduation. To this end, this paper proposes two key adjustments to the current conceptualization of graduation strategies, namely:

i. **The introduction of a policy framework to help refocus the objectives and strategic direction of the graduation strategy; and**

ii. **A new timeframe for the implementation of the strategy.**

Achieving this entails the design of long-term catch-up strategies to build the capabilities that graduating LDCs need to achieve 'graduation with momentum' and catch up with other developing countries (ODCs). This can be achieved by transforming the smooth transition strategy from its current narrow perspective as a short-term post-graduation plan for the utilization of international support mechanisms (ISMs), into a ‘long-term’ and broad-based strategy to expand the productive capacities of graduating countries with a view to achieving ‘graduation with momentum’.

The paper recommends LDCs to adopt a Strategy for Graduation with Momentum (SGM) based on three important elements: expanding productive capacities; fostering structural transformation; and catching-up with ODCs. A starting point for strategies based on this framework is the development of productive capacities which determine both the depth of the structural transformation that a country can achieve, as well as the prospect for catch-up. An SGM is underpinned by a Productive Capacity Gap Assessment (PCGA), which clearly spells out the policies needed to build new and enhance existing productive capacities at the national level. Graduating LDCs should conduct a PCGA to:

i. Establish the level of development of a graduating country’s productive capacity and the gap with ODCs. Designed to benchmark the development of productive capacities of countries, UNCTAD’s new Productive Capacity Index (PCI) is an effective tool to assess whether a graduating country is catching up, and which aspects of productive capacity building are advancing or lagging;

ii. Review the variations in the degree of development among the eight different components of productive capacities identified in the PCI, namely: natural capital; human capital; institutions; structural change; energy; private sector development; ICT ecosystem; and transport. The objective of this exercise is to gauge whether any progress has been made in building productive capacity, and whether this is compatible with the country’s comparative advantage and sectoral specialization. It also seeks to uncover the principal root causes why countries may be lagging behind in different domains;

iii. Recommend the specific areas of productive capacities that require international support and priority attention in the SGM. This is important as the development of productive capacities involves the expansion of a wide range of capabilities, infrastructure, competencies and skills, which LDCs may not be able to develop at the same time, or at the same rate;

iv. Identify domestic policies and specific ISMs – both from existing ISMs and other targeted support measures tailored to the individual graduating country – which should be incorporated into the SGM. Given the heterogeneity of LDCs, a one-size-fits-all approach will not be appropriate. An SGM will therefore pay greater attention to those policies and institutions that will enable a graduating country to: (i) expand and/or strengthen its own productive capacities in accordance with its comparative advantage; (ii) enable to maximize the benefits it can draw from its comparative advantages; (iii) achieve 'graduation with momentum'; (iv) and continue to grow and catch up with ODCs, even after graduation.

UNCTAD recommends a PCGA-based SGM to be undertaken within one year after meeting the graduation criteria for the first time. An early start to the process is crucial as it allows countries to focus on their productive capacities and structural transformation as they form key components of a long-term development strategy. Furthermore, assuming that: (i) 'graduation with momentum' strategy based on the PCGA, Impact Assessments and the Vulnerability Profiles are prepared within a year of meeting the graduation criteria for the first time; and (ii) that the extension by 5 years of both the preparatory period after the UN General Assembly's (UNGA) recommendation for graduation and the transition period after final graduation, leaving the graduating country with a total of 12 years to expand its productive capacities and catch up with ODCs.

Lastly, the COVID-19 shock could not have come at a worse time for graduating and graduated LDCs. The main focus of LDC governments is likely to be on how to reverse the economic decline resulting from the COVID-19 pandemic, and restore their economies to pre-pandemic levels. However, growth alone – even at a higher rate – will be insufficient if it does not enable them to: (i) achieve 'graduation with momentum'; (ii) create productive jobs; (iii) and foster structural transformation. LDCs will only be able to tackle the adverse consequences of unemployment and declining living standards through the expansion of productive capacities and the creation of productive jobs. Achieving these objectives will require shifting the policy focus of existing strategies towards the development of productive capacities.

Support measures, such as ISMs, can be helpful if designed and implemented in such a way as to enable LDCs to develop their productive capacities. The effectiveness of ISMs, particularly trade-related ISMs, will be insignificant if the beneficiaries do not have the necessary productive capacities to utilize them.

I. Introduction

The 2011 Istanbul Programme of Action (IPoA) established a target that half of all LDCs should satisfy the graduation criteria by 2020, but only a handful have done so to date. This largely reflects the limited progress they have made in the structural transformation of their economies. It also reflects the anxiety that some LDCs have about their development path following graduation, particularly with respect to: (i) the loss of access to LDC-specific international support measures (ISMs); (ii) the risk of a "middle-income trap"; and (iii) continuing uncertainty on transition arrangements. Countries achieving the graduation criteria have often done so without significantly developing their productive capacities and/or engaging in any meaningful forms of structural economic transformation. Equally, the limited productive and institutional capacities of LDCs have been important constraints, or severely constrained their ability make effective use of ISMs.

These stylized facts highlight the importance of the development of productive capacities and a smooth transition strategy to accelerate the rate with which LDCs achieve graduation on a sustainable basis, and on an economic and developmental base for continued development - what UNCTAD has termed a 'graduation with momentum' (UNCTAD, 2016).

To achieve this objective, this paper proposes a strategy for a 'graduation with momentum', composed of the following four key elements:

i. The preparation and implementation of the smooth transition strategy should commence well before a graduating country leaves the LDC category;

ii. A Productive Capacity Gap Assessment (PCGA) should be conducted within one year of a country meeting the graduation criteria for the first time. The outcome of the PCGA should serve as a basis for designing the policies and strategic direction of the Strategy for Graduation with Momentum (SGM);

iii. The preparation of the SGM should be driven by a policy framework built around three key processes, namely: the development of productive capacities; structural transformation; and a process of catching-up; and

iv. Development partners should extend the preparatory period after the UNGA's recommendation for graduation and the smooth transition period after graduation by 5 years.

1 This is in line with a recent proposal by the Committee on Development Policy (CDP) to start the preparatory process for graduation as soon as a country meets the graduation criteria for the first time. However, this paper builds on that proposal and suggests that the preparation for 'graduation with momentum' should begin within the first year of a country meeting the graduation criteria for the first time rather than after meeting the criteria for second time, as currently practiced.

> Assuming the PCGA is completed within a year after meeting the criteria for the first time, and assuming further that both the preparatory period and the smooth transition period are extended by five years, a graduating country would thus have 12 years to expand its productive capacity, catch-up with other developing countries (ODCs) and prepare to trade internationally without the need for LDC-specific ISMs.

This paper will expand on these four elements, including the policy framework for preparing a new SGM. The paper is divided into six sections. Section II assesses recent experiences of graduation. Section III looks back to understand why, after 50 years of LDC-specific ISMs, the majority of LDCs are graduating with limited development of productive capacities, which are impeding their catching-up with ODCs. Section IV examines the objectives of the smooth transition strategy and the effectiveness of this policy tool in assisting graduated countries to continue with sustainable development, and avoid potential pitfalls during the post-graduation transition period. Section V develops a more conducive policy framework to structure an SGM that contributes to sustainable development and structural transformation prior to and after graduation. This policy framework assigns greater weight to the development of productive capacities and the interrelated processes of structural transformation and catching-up. Section VI argues for the need for a new generation SGM and introduces a paradigm shift in the formulation and implementation of traditional smooth transition strategy. The section also presents the objectives and strategic direction of the SGM and the principles and values that will guide its formulation and implementation. Section VII identifies the key policy ingredients needed to develop productive capacities and foster structural transformation and catching-up beyond the smooth transition period. Finally, Section VIII presents concluding remarks.

II. Recent LDC Graduation and Transition Experiences

Graduating from the LDC category reflects the economic and social progress a country has made, as well as the shedding of the stigma that is often attached to remaining in a special category of countries composed of the poorest and least developed of developing countries. In this respect, it has been encouraging to see that more and more LDCs have met the graduation criteria over the past few decades. Undoubtedly, the quantitative target agreed in the last United Nations Decennial Conference on LDCs (9-13 May 2011,Istanbul, Turkey) for the number of LDCs meeting the graduation criteria by the end of the 2020 was significant in generating momentum towards graduation. The Istanbul Programme of Action (IPoA) comprised a multitude of development goals and targets, including the most ambitious and seminal goal of “enabling half the number of least developed countries to meet the criteria for graduation by 2020” (IPoA, 2011, p.6). Given the number of LDCs at the time, achieving this goal would have meant that 24 LDCs would have needed to meet the graduation criteria by 2020.

The prominence given to graduation as a priority goal was necessary and timely, particularly in view of the slow progress made in the four decades preceding the Istanbul conference. Only three countries (Botswana, 1994; Cabo Verde, 2007; the Maldives, 2011) were able to graduate between 1971 and 2011 – about one country per decade. As the end of 2020 approached, it became clear that the graduation target set by the IPoA would not be met as only three countries have graduated since 2011 (Samoa, 2014; Equatorial Guinea, 2017; Vanuatu, 2020). Despite meeting the income-only criteria for graduation since early 2000, Equatorial Guinea resisted graduation for many years as it feared losing ISMs; even though as an oil-rich country, it did not meaningfully use them. In December 2020, after deferring the graduation timeline twice, Vanuatu became the third country to graduate within the IPoA timeframe.

When reviewing the progress made towards meeting the criteria for graduation during the implementation of IPOA, two important trends can be observed.

First, although the IPoA target for graduation was not achieved, the number of LDCs that have met the graduation criteria for the first time has increased significantly, and more countries are incorporating graduation strategies into their development plans. For example, the CDP’s triennial review in 2018 found that three countries (Bangladesh, Lao PDR, Myanmar) met the graduation criteria for the first time, and were found to have met the criteria for the second time in the subsequent CDP triennial review in February 2021. The CDP recommended the graduation of Bangladesh and Lao PDR from the LDC category, alongside that of Nepal, which had previously qualified for the second time. Timor-Leste also met the graduation criteria for the second time in 2018, but was not recommended for graduation – a decision repeated in 2021.

The other three countries are on course to graduate and leave the LDC category. The CDP has recommended that the preparatory period for graduation for this group of countries be extended from the standard three years to five years because of the concerns these countries have in the face of the severe nature of global health and economic crises brought on by the COVID-19 pandemic. In principle, therefore, the three graduating countries (Bangladesh, Lao PDR and Nepal) will be removed from the LDC category in 2026.

In addition, six additional countries have already been recommended for graduation by the CDP, and scheduled to leave the LDC category between 2021 and 2024. These include Angola (2024), Tuvalu (2021), Kiribati (2021), Bhutan (2023), Sao Tome and Principe (2024), and Solomon Islands (2024). However, Kiribati, Tuvalu and Angola have also requested a deferment of their graduation due to the devastating health and economic impact of the Covid-19 shock. A 3-year deferment of the graduation of Angola was granted by the UNGA one day before its scheduled graduation date. Finally, during the triennial review in February 2021, the CDP identified five LDCs that met the graduation criteria for the first time, namely: Cambodia, Comoros, Djibouti, Senegal and Zambia. Cumulatively, the progress made towards meeting the graduation criteria since the Istanbul Conference in May 2011 suggests that efforts to push the graduation agenda has paid off, and that current trends are encouraging. This should inspire other LDCs, especially those on the African continent, which are still far behind in meeting the graduation criteria. By the time the CDP meets for its next triennial review in 2024, 32 of the remaining 39 LDCs will be African.

Second, as the number of LDCs eligible for graduation increases, a new and worrying phenomenon has emerged. Graduating countries are becoming increasingly anxious that the loss of ISMs after graduation will disrupt their development trajectory[2]. Paradoxically, even those countries that are graduating through the income-only criterion and that have not extensively relied on the LDC-specific trade-related support measures, e.g. Angola and Equatorial Guinea, have voiced reservations about graduation, arguing that they are losing trade-related preferences and privileges before they had the opportunity to utilize them effectively. Other graduating countries are concerned that they may fall back into the LDC category if not allowed to continue to benefit from LDC-specific special support measures following graduation.

[2] Although concerns about post-graduation development challenges were also expressed by countries that graduated earlier, countries have become more vocal as the number of graduating countries increased, especially those that have made effective use of ISMs to achieve growth and meet the criteria for graduation.

[3] Although there is no consensus on the definition of the ‘middle-income trap’, the concept provides insights into the growth and development challenges that countries face as they move up the development ladder and try to continue to catch-up with upper middle-income and advanced economies (UNCTAD, 2016).

Another concern faced by graduating LDCs is the possibility that they may fall into the so-called "middle-income trap"[3] after graduation. The term 'middle-income trap' describes the dilemma faced by a growing number of countries that have successfully reached middle-income level but continue to have low-productivity, low-technology/low-value production systems and limited productive capacities; these countries are also unable to break through to high-income status, or into fully developed wealthy economies (Glawe & Wagner, 2016). Graduating LDCs fear that the loss of LDC status and their treatment as any other lower-middle income developing country will increase the potential of remaining stuck in a 'lower-middle-income trap'. As countries leave the LDC category, this 'fear of the unknown' is testing the confidence of graduating countries. Indeed, even among countries that have already met the criteria, the uncertainty has created an apprehension and reluctance to graduate. This new trend has, in turn, intensified the call for post-graduation transitional arrangements, and for a strategy to ensure that the post-graduation transition process is less painful, more predictable, and as smooth as possible. This calls for the introduction of a 'smooth transition strategy' –as a time-bound and short-term post-graduation measure – to ensure that the loss of LDC-specific ISMs after leaving the LDC category does not disrupt the development progress of a graduating country. While the issue of a 'smooth transition' has been the subject of discussion since the establishment of the LDC category in 1971; however, several intergovernmental decisions, including the UNGA resolution 67/221 of 2012, taken after the Istanbul Conference in May 2011 called for effective smooth transition arrangements to be made. However, the post-graduation transition process remains highly ambiguous and unpredictable.

This lack of clarity is adding to the anxiety of some graduating LDCs. In some cases, it has led to delays in the graduation timeline. In the absence of a systematic approach to a smooth transition, the ability of graduating countries to retain access to ISMs for a transition period is largely dependent on their capacity to negotiate with development partners, at both the bilateral and multilateral level. These uncertainties have created ambiguities on: (i) the timing for the preparation of a smooth transition strategy; (ii) the differences between the preparatory and smooth transition periods; (iii) the scope of the policies and issues to be covered in the smooth transition strategy; and (iv) the timeframe for the implementation of the strategy, and so on.

In this connection, UN DESA's preparation of a Template and Guidance Note on how to prepare a 'smooth transition strategy' is commendable and a step in the right direction, and helps to clarify some of the confusion surrounding the strategy (UN DESA, 2020). However, the 'template' is not a 'blueprint' for a smooth transition strategy, but rather serves as a guideline on the process that graduating countries should follow as they prepare a smooth transition strategy. More work is still needed on the objectives of a smooth transition strategy, as well as the policies and strategic directions that graduating countries should pursue in the post-graduation development phase.

Building on recent work, this paper proposes an alternative framework for an SGM. This framework is based on the premise that if graduating LDCs do not expand their productive capacities, they will not achieve sustainable development and move up the technology and value ladder after graduation. As discussed in Section V, productive capacities are the diverse competencies, natural and financial resources, skills, infrastructure, technological capabilities, institutions and systems, that a country needs to efficiently and competitively produce increasingly more sophisticated goods and services. If LDCs do not acquire some, if not most of these essential elements of productive capacities while benefiting from ISMs, they are unlikely to achieve 'graduation with momentum' (UNCTAD, 2016, p.162). If not achieved, post-graduation challenges may create setbacks and even the reversal of the progress made prior to graduation. Thus, the main novelty in the alternative framework proposed in this paper is that it explicitly links the graduation strategy with the development of productive capacities, and the process of technological catching-up with other relatively more developed developing countries.

Three sets of lessons from recent experiences of graduated and graduating countries reinforce the importance of linking the SGM with the development of productive capacities.

First, not all graduated countries achieved eligibility for graduation by developing their productive capacities. In a recent study, the CDP categorizes graduated and graduating countries into three groups depending on the pathways they followed to meet the graduation criteria (CDP, 2017).

i. The first group includes countries, such as Angola and Equatorial Guinea, which became eligible for graduation by fulfilling the income-only criteria due to the high revenue they generated from the exploitation of natural resources. Both these countries depend exclusively on oil and gas for growth and export earnings. However, while they have been able to make some progress in developing productive capacities, they have made little to no progress in structurally transforming their economies. As a result, by the time they met the graduation eligibility criteria, very limited progress had been made in terms of the Human Assets Index (HAI) and Economic and Environmental Vulnerability Index (EVI) – both necessary requirements for meeting the graduation criteria.

ii. The second group is comprised of countries that have achieved eligibility for graduation by specializing in a single sector, or a few economic activities within a particular sector, or by investing in human assets. Such countries include recently graduated countries, such as Cabo Verde, Maldives, Samoa and Vanuatu, as well as other countries currently eligible for graduation, e.g. Bhutan, Solomon Islands and Kiribati. These countries have attained sustained growth and improvements in human assets by specializing in either tourism (Maldives, Cabo Verde, Samoa, Vanuatu), or in the production and export of energy (Bhutan), or logging (the Solomon Islands). Most of these countries are small economies that have invested in a particular sector in which they had a comparative advantage, and invested their earnings in human asset development, in particular education. These measures have helped them to increase GNI per capita above the required threshold for graduation and significantly improve their performance in HAI both necessary requirements for meeting the graduation criteria. However, while progress in human assets development contributes to the expansion of productive capacities, in general the productive capacities of these countries have remained underdeveloped.

Unlike the first and the second groups, the third group consists of countries that invested in human assets, as well as in the diversification of their economic activities and sector, including technological capabilities and competencies. The latter are necessary to develop diverse economic activities and sectors, as well as essential technological capabilities and competencies, and to build their productive capacities and foster structural transformation. This group of countries have begun to lay down the foundations needed to expand their productive capacities and promote structural transformation, and move away from low-productivity agriculture into higher-productivity manufacturing and modern services. Unfortunately, not many LDCs that have met the eligibility criteria for graduation have taken this path. Bangladesh is an exception in this regard, although other graduating LDCs, such as Laos PDR and Nepal, have also initiated policies to promote economic diversification. In terms of the LDC criteria, countries in the third group typically meet all the three criteria for graduation – GNI per capita, HAI and EVI – by investing in the development of productive capacities, they have embarked on a process of sustainable development and catching-up with ODCs. This represents the desirable path towards graduation as it ensures ‘graduation with momentum’.

Second, not all LDCs are effectively utilizing the LDC-specific ISMs, and particularly the trade-related support measures. Trade-related ISMs are the most important LDC-specific support measures that development partners have at their disposal to assist

LDCs to integrate into the multilateral trading system, attract investment, participate in international markets, and compete with other more advanced developing countries. LDC-specific trade-related ISMs, include: (i) duty-free quota-free market access for goods and services; (ii) exemptions from certain obligations under WTO rules; (iii) and trade-related technical assistance and capacity-building. While several LDCs have benefited from some of the trade-related ISMs, a limited number of LDCs have utilized trade-related support measures to the maximum and advanced their capacities to meet the graduation criteria as a result. For example, a recent WTO/EIF study on the utilization of trade preferences by graduating countries found that only one of the 12 countries scheduled for graduation in the coming 5-7 years – Bangladesh – had utilized the preferential market access privileges and the WTO waiver granted to LDCs effectively to achieve the three criteria for graduation (WTO-EIF, 2020).

Third, the primary reason for the low utilization of trade-related support measures by LDCs is the limited development of their productive capacities, which also restricts their abilities to foster structural transformation and catch-up with ODCs (UNCTAD, 2010). This implies that most LDCs are meeting the criteria for graduation before they are able to develop their productive capacities, and acquire the technological and production capabilities that graduated countries need to engage in global markets on an equal footing with ODCs. This raises an important question on the rationale for the smooth transition strategy: if most LDCs are unable to utilize the most important ISMs granted to them due to limited development of productive capacities, how realistic is it to expect that extending existing ISMs for a short transition period after graduation would make a significant difference to sustainable development once they have graduated? A related question is what are the objectives of the LDC-specific ISMs? Are they to assist LDCs to achieve a minimum level of development, as measured by a selected number of social and vulnerability indicators, or are they formulated to enable these countries to narrow the development gap with ODCs, and acquire the productive and technological capabilities they need to participate in the international trading system as equal partners? An equally important question is what graduating countries' need to transform the smooth transition strategy into an effective instrument of 'graduation with momentum'. More specifically, what are the policies and strategic directions that will make the smooth transition strategy an effective tool for building productive capacities, foster structural transformation, and enable graduating countries to catch up with ODCs? These sets of questions will guide the rest of the discussion in this paper.

III. Trade-Related Measures & the Development Trajectory of LDCs in the 21st Century

In the spirit of an African proverb, "life is lived forwards but understood backwards", this section briefly looks at the origin of the LDC category, to understand the current LDCs' predicament of 'graduation without momentum', and to determine the best way forward for countries to meet the graduation criteria. An important starting point is the policy thinking and strategic imperatives that led to the establishment of the LDC category some 50 years ago, and the influence these elements had on the criteria used to identify LDCs and to decide on ISMs.

The idea of classifying low-income and structurally weak developing economies as 'least developed countries' originated in the first session of the United Nations Conference on Trade and Development (UNCTAD) held in Geneva, Switzerland, in 1964[4]. Special attention was given to the "less developed" among developing countries, the challenges they faced in international trade, and the need to rebalance the disparity between countries through targeted ISMs. However, at the time, there was no consensus among the newly formed group of developing countries (i.e. G77) on country classification, largely because of concerns that such differentiation among developing countries would harm the unity of the G77 (Fialho, 2011). However, four years later, at the second session of UNCTAD in New Delhi, India, there was less objection to identifying the least developed, structurally weak and the most vulnerable and disadvantaged countries in the developing world as a special group requiring tailored and targeted support by the global community. By then, the G77 was well established as a group, and India – as the host of the second conference and in solidarity with the poorer and structurally weak developing countries, pushed for a consensus within the G77 by advocating for "special measures in favour of the least developed among developing countries"[5]. The UNGA subsequently approved a resolution to establish the LDC category in November 1971.

Following the UNGA's decision, UNCTAD was requested to assemble an expert group consisting of academics and experts from international organizations to deliberate on what was then called the "typology" of developing countries, and to assess the "general situation" of the countries that could be characterized as the 'least developed among developing countries' (UNCTAD, 1970). The work of the expert group was influenced by two contrasting school of thoughts on economic development and the benefits of integration into the global trading system. These two schools consisted of the neoliberal economic model, which emphasized the importance of markets and integration into the international trading system, and the structuralist theory of development, which at the time was the model advocated by UNCTAD and its first Secretary General, Raul Prebisch (UNCTAD, 1985).

4 For details on the origin and evolution of the LDC category, see UNCTAD (1985, 2016) and Fialho (2011).

5 The final outcome document of UNCTAD II (1968) states that "special measures to be taken in favour of the least developed of developing countries are aimed at expanding their trade and improving their economic and social development" (Resolution 24(II)).

For the structuralist development school, the wide income and development gap between least developed and more developed countries was the result of the continuing dependence of the poorer economies on production and exports of commodities and imports of higher-value manufactured products from developed countries. This was considered problematic as the prices of developing-country exports tended to decline relative to developed-country exports (largely industrial goods), leading to a chronic deterioration in developing countries' terms of trade[6]. According to this school, countries at an early stage of development faced a structural disadvantage in their trade relations with more developed economies, which magnified the income gap between rich and poor countries. Industrialization, particularly diversification into manufacturing, was thought to be the solution to this problem. The expectation was that a shift towards manufacturing would reduce dependence on the production and export of primary commodities and ease the balance-of-payments constraints on development, either by replacing imports (though import substitution), or alternatively by generating additional export earnings (Prebisch, 1964). Therefore, it is not surprising that the expert group recommended the use of manufacture-related indicators to select those criteria that would identify the LDC category.

In contrast, the neoliberal school considered the root causes of the development challenges facing the least developed of developing countries to be due to the limited development of their markets, and their inability to access and compete in international markets. According to this school, ISMs were justified because LDCs were marginalized and excluded from the global marketplace, and were seen as instruments to address this shortcoming and help them to catch-up with ODCs (UNCTAD, 1985).

A. Early Policy and Strategic Directions

The combination of these divergent views influenced the policy and strategic directions proposed by the expert group resulted in three important strategic directions.

The first was the need to level the international playing field by supporting the poorest and structurally weak economies through LDC-specific ISMs, including special and differential treatment (SDT) in the rules and regulations governing the multilateral trading system. This principle became the basis for the subsequent formulation of ISMs in favour of LDCs and the efforts that were later made by the international community to ensure that LDCs benefit from international trade and economic relations. Therefore, as Fialho (2015, p.32) notes, "The mechanism behind

6 This is the so-called "Prebisch-Singer hypothesis", see Prebisch (1964).

the LDC category can be conceptualized as an international cooperation arrangement (between developed countries and LDCs, mediated by the UN) aimed, essentially, at correcting (or at least minimizing) the unequal global economic and development playing field, through the implementation of a rules-based international assistance system based on the preferential treatment of selected developing countries".

When viewed from this perspective, graduation from the LDC category is a recognition that LDCs have advanced to a point where they can pursue development on their own and compete internationally without resorting to LDC-specific ISMs. Insufficient attention was given to the fact that the international playing field is not static and changes over time as technologies evolve and the rules, standards and degree of sophistication of international economic and trading systems advance. The increasing globalization of the world economy over the past six decades has shown that the international playing field is a moving target, and the challenge for structurally weak and latecomer economies, such as LDCs, has been how to catch-up.

Second, the primary objective of facilitating market access was to fast-track trade-related policy reforms in LDCs, and to accelerate their integration into the international trading system. Achieving greater integration of low-income and structurally weak economies into the international trading system through the liberalization of trade regimes was regarded as an important precondition for economic growth as it: (i) increased income through exports; (ii) attracted FDI; (iii) created learning through linkages with more dynamic economies; and (iv) benefited from the transfer of technologies and know-how. As noted by Fialho (2015, p.32), "The central premise behind UN's decision to establish a special category for the least developed of developing countries was to promote a more global playing field to enable countries with structural impediments and development-hampering conditions to integrate into the international trading and economic system". Therefore, the primary purpose of promoting a level playing field was to facilitate entry of the goods and services from LDCs into the markets of more advanced developing and developed countries. Hence, the focus of ISMs on preferential market access through duty-free and quota-free arrangements.

---

7 The name of the CDP was changed from 'Planning' to Committee for Development 'Policy' by ECOSOC during the reform of its subsidiary bodies in 1989. Gay (2017) presents a detailed history of the CDP. The criteria and specific indicators used to determine graduation has evolved over the years. The original list included the following countries: Afghanistan, Benin, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Guinea, Haiti, Lao PDR, Lesotho, Malawi, Maldives, Mali, Nepal, Niger, Rwanda, Samoa, Somalia, Sudan, Uganda, United Republic of Tanzania and the Yemen Arab Republic. For a detailed discussion on the LDC criteria, see United Nations CDP and UN DESA (2015).As noted above, in December 2020 the UNGA recommended that Vanuatu was ready for graduation, the most recent country to have been so.

8 The original list included the following countries: Afghanistan, Benin, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Guinea, Haiti, Lao PDR, Lesotho, Malawi, Maldives, Mali, Nepal, Niger, Rwanda, Samoa, Somalia, Sudan, Uganda, United Republic of Tanzania and the Yemen Arab Republic.

Third, LDCs were seen to suffer from structural disadvantages in global trade relations due to their excessive dependence on primary commodity exports. Thus, based on studies conducted by UNCTAD, including an earlier report prepared by the first Secretary-General of UNCTAD, the expert group stressed the importance of diversification into the manufacturing sector as a solution for reducing LDCs' dependence on the production and export of primary commodities (Prebisch, 1964).

Drawing upon the findings of the expert group and on the recommendation of the CDP[7], the UNGA approved a list of 25 countries to be included in the LDC category[8].

Three criteria were used to identify countries, namely: (i) GDP per capita of $100 or less; (ii) an adult literacy rate of 20 per cent or less; and (iii)[9] a share of manufacturing in total GDP of 10 per cent or less.

The initial indicators used to identify LDCs are quite telling as they indicate the importance attached at that time to economic diversification and the development of the manufacturing sector, which is a key ingredient in the development of productive capacities. Historically, sustained economic growth and structural transformation have been closely related to industrial development, with manufacturing playing a critical role in the latter. As shown by developed economies and the newly industrialized Asian economies more recently, the development of a broad and robust domestic manufacturing base has been key to successful economic development, as it has helps to generate linkages with other sectors of the economy, drive technological progress, and has the strongest potential for productivity gains (UNCTAD, 2020a). As manufacturing grows, countries rely less on the primary sector and become more efficient through the greater use of capital and technology. This is the basis for rapid development of productive capacities and, in the case of LDCs, the pathway towards 'graduation with momentum'. However, it remains unclear why, after having initially introduced the share of manufacturing in total GDP as one of the criteria for inclusion into LDC category, the CDP subsequently dropped it, and instead gave more weight to social indicators.

Since the early 1970s, the number of LDCs has steadily increased, reaching a peak of 51 countries in 2003. As of April 2021, the number of LDCs has fallen to 46 – close to double the number of the original list[10]. Also noteworthy is that LDCs now comprise about 14 per cent of the world's population, but account for less than 1.3 per cent of the world's GDP, and about 0.9 per cent of world trade.

9 For a detailed discussion on the LDC criteria, see United Nations CDP and UN DESA (2015).

10 As noted above, in December 2020 the UNGA recommended that Vanuatu was ready for graduation, the most recent country to have been so.

B. Implications of ISMs on the Development Trajectory of LDCs

This brief historical synopsis points to three important conclusions that have direct implications for the development trajectory of LDCs in the 21st century.

First, while the primary motivation behind the establishment of the LDC category and LDC-specific ISMs was to create a level playing field for structurally weak and 'least developed' developing countries, the design of the LDC-specific ISMs paid insufficient attention to: (i) the evolving nature of the rules of engagement and the level of standard of the playing field; and (ii) the constant need of countries to upgrade and catch-up. For example, learning from more successful economies, many LDCs are currently attempting to achieve sustained growth and structural transformation by adopting export-led industrialization strategies. The rapid growth of the newly industrialized economies in East and South-East Asia have been attributed to export-oriented industrialization strategies anchored in the manufacturing sector. However, implementing the same strategy has now become much more difficult than five decades ago: The global economy is now much more open and crowded with a multitude of countries simultaneously vying to realize the promise of export-led industrialization by exporting the same types of low-value manufactured products to the same markets. Thus, in today's highly interdependent international production system, the playing field for trade has changed. It is also increasingly dominated by global value chains (GVCs), and success in this field depends heavily on the level of development of productive capacities and the ability of countries to integrate GVCs. These important factors were not taken into consideration in the design of LDC-specific ISMs.

Second, preferential market access (i.e. duty-free and quota-free market entry) for exports from LDCs was regarded as a key ISM and found to be critical in accelerating development. This was because the belief that the challenges facing the LDCs were the result of their "insufficient exposure to correct market prices and conditions" (Gay, 2019). Thus, when "the market distortions in the form of tariff and non-tariff barriers to trade are removed, and after a temporarily higher period of development assistance, these countries' will, the assumption goes, be freed up to play fuller role in the international order" (Gay, 2019). Fifty years after the creation of ISMs, it has become clear that removing tariff and non-tariff barriers to exports from LDCs will not make LDCs efficient and effective players in international trade. The core problem is not market entry per se but rather the limited development of their productive capacities. These are critical to producing a diverse range of products and competitively participating in international markets. The current low utilization of trade-related ISMs by LDCs is due to the limited development of their productive capacities. This clearly demonstrates that the design of LDC-specific ISMs was based on misguided assumptions on the core challenges facing LDCs.

Third, from the brief historical analysis in this section, it follows that, despite nearly 50 years of international support to LDCs, the challenges facing this group of countries remain as pervasive and constricting as they were in 1971. The current concern with the post-graduation development trajectory and the appeal **by** graduating countries for a lengthy smooth transition period should be understood in this context. The expectation at the time of the establishment of the category was that, as countries caught up, with the assistance of ISMs, the number of LDCs would shrink to a point where there would not be any "least developed" countries in the world. In reality, the opposite has happened: Not only has the number of LDCs nearly doubled but the socio-economic gap between them and ODCs has also widened, marginalizing them even further. As UNCTAD notes, "The 2030 Agenda for Sustainable Development and Sustainable Development Goals have the avowed aim of 'leaving no one behind'; however, LDCs are the epitome of those that have been left behind in the global economy, both economically and in human development" (UNCTAD, 2016, p.32).

In November 2021, the UN will celebrate the fiftieth anniversary of the establishment of the LDC category. Three months later, in January 2022, the Government of Qatar will host the Fifth United Nations Conference on LDCs in Doha where the global community will gather to evaluate progress in the implementation of the IPoA, reflect on the lessons learnt, and decide on the priority areas of the IPoA. This forthcoming conference provides a timely opportunity to re-evaluate the effectiveness of existing ISMs and the core challenges constraining the abilities of LDCs to 'graduate with momentum'. As UNCTAD has repeatedly argued, the root cause of LDCs' structural impediments and their concern for sustainable development on graduation is their lack of progress in the development of productive capacities. The Doha Conference will provide a timely opportunity for LDCs and their development partners to act. The following two issues will be key to the process.

First, the CPD recommendation that LDCs should adopt 'expanding productive capacity for sustainable development' as a framework for organizing their own programme of action for the decade 2021-2030. This will not only give the PoA a sharper focus but also present a coherent and integrated approach to achievements in other priority areas LDCs' wish to address in the current decade.

Second, a rethink by LDCs of their approach to the smooth transition strategy. Given the importance of developing productive capacities to achieve 'graduation with momentum', graduation strategies should be designed as a broad-based policy to expand productive capacities prior to and after graduation, strategy for the utilization of ISMs after graduation.

IV. The Rationale of the SGM and the Challenges it Faces

The absence of effective, systematic and binding support to LDCs during the post-graduation transition period has been a source of frustration to these countries. Unfortunately, not all development partners are convinced that LDC-specific ISMs need to be continued after graduation. Nevertheless, concerted efforts have been made to convince development partners, including at the multilateral level, that graduating countries need international support as they adjust to a post-graduation development trajectory. For example, in November 2020, the LDC Group in Geneva submitted a proposal for an "effective smooth transition mechanism for graduating LDCs" to the WTO General Council[11]. The proposal was a draft ministerial decision to respond to UNGA Resolutions, which included the introduction of a comprehensive and predictable smooth transition arrangement for graduating LDCs under the WTO system. Under this proposal, a decision should be taken at the next WTO Ministerial Conference to allow LDCs to continue with LDC-specific support measures (particularly the TRIPS waiver, but also other special and differential treatment (SDT) measures, for a period of 12 years after graduation. Similarly, another proposal was tabled in October 2020 proposing the extension of SDT of LDCs in the case of the TRIPS Agreement.

Whether the next WTO Ministerial Conference will agree to extend LDC-specific support measures at the WTO for 12 years after graduation remains to be seen. Preliminary discussions at the General Council suggest that not all development partners are convinced that an extension of such measures for more than a decade after graduation is warranted. Nevertheless, LDCs are determined to pursue the matter, which will be discussed again by the General Council before the next Ministerial Conference.

Two LDC ministerial meetings declarations in the past three years have made it clear that graduating countries would like to see a systemic approach to a smooth transition in line with UNGA resolutions and the consensus that emerged from the last United Nations Decennial Conference on LDCs (Istanbul, Turkey, May 2011). For example, LDC Trade Ministers at the 11th WTO Ministerial Conference (Buenos Aires, Argentina, 2017) issued a Declaration (WT/MIN(17)/40) calling on development partners to extend LDC-specific preferences to graduated countries for a period appropriate to the development situation of the country in question.

Similarly, a Ministerial Declaration from a meeting of LDCs' Foreign Ministers held in New York in September 2018 (see Annex 1) identified a series of measures that development partners could introduce to support graduating countries during the transition period. The proposed measures included supporting the mobilization of resources for: (i) the implementation of the SDGs; (ii) trade-related capacity building; (iii) predictability in the extension of ISMs; (iv) additional support measures to ease the challenges facing

[11] See:https://sdg.iisd.org/commentary/policy-briefs/wto-members-review-challenges-options-for-graduating-ldcs/Ministerial Declaration of the Least Developed Countries, New York, 26 September 2018, para. 47. For details of the specific measures proposed by LDC ministers, see Annex I.

graduating countries; (v) an extension of the preparatory period before graduation from 3 to 5 years; and (vi) the extension of exemptions and waivers and other support measures provided by the WTO for a reasonable period, etc[12]. While acknowledging that graduation from the LDC category is a tangible sign of socio-economic progress, LDC ministers noted that it also imposes new challenges due to the loss of LDC-specific benefits and waivers from compliance with international obligations and commitments. In their Ministerial Declaration, they called upon development partners "to agree on a package of benefits that the graduated countries will continue to enjoy in some critical areas of their economy for a certain period of time consistent with their development situations and needs. This can serve as a safeguard measure for the graduated countries to sustain their development path and not to relapse to the category of LDCs".

A. The Smooth Transition Mechanism

The call by LDC Ministers for a systemic approach to the smooth transition mechanism and for clarity on the objectives of a smooth transition strategy, is legitimate in view of the development challenges faced by graduated and graduating LDCs. Several LDCs meeting the graduation criteria have delayed their graduation timeline, in some cases for a lengthy period. This suggests that the lack of a systemic approach to post-graduation smooth transition mechanisms is a major concern, and could form an obstacle to accelerating graduation from the LDC category. After becoming eligible for graduation, Samoa, Maldives and Cabo Verde all graduated much later – 23, 14 and 13 years, respectively. More recently, Tuvalu, Kiribati and Vanuatu all delayed graduation, although Vanuatu finally graduated in December 2020.

Understandably, some LDCs, e.g. Vanuatu, Maldives and Tuvalu, delayed graduation for legitimate reasons, most notably the massive destruction caused by natural disasters. However, in other cases, the hesitation to graduate has been policy driven. Angola and Equatorial Guinea are two examples, among others, of countries that have chosen to remain on the LDC list, even after meeting the graduation criteria (income-only criterion) as far back as the 1990s. At first glance, the reluctance of countries to exit the LDC category even after meeting the criteria, and their preference instead to remain on the LDC list may appear perplexing. Meeting the graduation threshold, which exemplifies that a country has achieved significant and measurable economic and social progress, should bring pride and prestige. However, valid concerns remain and the global community needs to hear and address these issues upfront, if the graduation target agreed in the IPoA is to be achieved by the end of the 2020s.

12 Ministerial Declaration of the Least Developed Countries, New York, 26 September 2018, para. 47. For details of the specific measures proposed by LDC ministers, see Annex I.

B. Factors Underpinning the Resistance to Graduation or is the current Smooth Transition Strategy obsolete?

The key factor behind the resistance to graduation is the fear of losing ISMs, given that no alternative support programmes exist at present to mitigate the immediate negative socio-economic effects arising from the withdrawal of LDC-specific support measures. In fact, until recently, LDCs had no guideline or roadmap to navigate through the transition period, and cope with the immediate challenges that graduated countries may face as non-LDCs. Smooth transition is understood in terms of winding down ISMs, rather than preparing the graduating countries for the challenges ahead and supporting them in their quest to succeed as middle-income economies. This understanding of the smooth transition mechanism, as a short-term post-graduation measure, has remained consistent since the establishment of the LDC category in 1971. Only UNCTAD has voiced differing views linking the graduation process with the development of productive capacities, 'graduation with momentum', and long-term post-graduation sustainable development.

In 1971, for example, the CDP report to ECOSOC stated that, "To avoid the unfavourable effects of sharp discontinuities in policy, it should be understood that a country would not automatically be deprived of special measures as soon as it ceased to qualify as least developed country"[13]. Twenty years later, in 1991, the first UNGA resolution on the smooth transition stated that, "(….) There is a need for a smooth transition of the countries graduating out of the group of least developed countries, with a view to avoiding disruption to their development plans, programmes and projects …". Similarly, the IPoA declared that, "Smooth transition of countries graduating from least developed country status is vital to ensure that these countries are eased into a sustainable development path without any disruption to their development plans, programmes and projects. The measures and benefits associated with the LDC membership status need to be phased out consistent with their smooth transition strategy, taking into account each country's particular development situation" (UN, 2011). Thus, the consistent understanding of the smooth transition strategy over the last four decades has been that it is a short-term transitional strategy aimed at preventing possible development disruptions following the withdrawal of ISMs.

For UNCTAD, an SGM provides an opportunity to build an LDC's domestic capacity for long-term development after graduation. "…The process of development beyond graduation merits much greater attention, even during the pre-graduation period – that graduation itself should not be the primary focus of LDCs and their development partners but should rather be viewed as one milestone in LDCs' long-term sustainable development" (UNCTAD, 2016, p.126). In other words, meeting the graduation criteria

13 The 2017 CDP report on 'procedures for graduation from LDC category' contains references to various statements made on smooth transition since 1971.

is not the solution to all of a graduating country's development challenges; rather, the challenges of the post-graduation period are a continuation of those that characterized the pre-graduation period.

While the issue of smooth transition has been with us as long the LDC category has existed, it is mainly since the Istanbul Conference in May 2011 that it has acquired a formal institutional dimension. This Conference invited the UNGA "to establish an ad hoc working group to further study and strengthen the smooth transition process" (IPoA, p.46). A working group was established in 2012 and, on its recommendation, the UNGA reinforced the need for a smooth transition mechanism based on the principle of a phased withdrawal of LDC-specific support measures to avoid disruption in the development progress of the graduating countries. More specifically, the UNGA resolution invited "trading partners that have not established procedures for extending or phasing out preferential market access … to clarify in a predictable manner, their position with regard to the extension of the least developed country-specific preferences, the number of years of the extension or the details concerning the gradual phasing out of the measures" (UN, 2013, p.3). In addition, the UNGA invited "graduating and graduated countries to implement a smooth transition strategy as part of their overall development strategy and to incorporate it into relevant (national development) documents" (UN, 2013, p.3, emphasis added).

In response to the UNGA's recommendation, UN DESA has published a Template and Guidance Note that outlines the steps to be taken when preparing a smooth transition strategy (UN DESA, 2021). This document is a manual to guide countries on how to prepare a post-graduation transition strategy, and does not address the policies, or the strategic directions to be followed during the transition period. These are left to graduating countries to determine, depending on their specific needs, conditions and the pathways they followed to achieve graduation.

UN DESA's commendable efforts are a step in the right direction. However, many questions and ambiguities remain on the smooth transition mechanism and related strategies, as well as their objectives and implementation timeframe, and require further investigation. Building on UN DESA's template, this paper introduces a policy framework for preparing an SGM which provides graduating countries with the policies and strategic directions needed to move onto a post-graduation development trajectory. A key principle guiding the framework is UNCTAD's consistent message that, in pursuing the graduation agenda, LDCs should aspire to achieve 'graduation with momentum' as the primary objective. After graduation, they should not look back but rather move forward and build on the momentum that enabled them to achieve for graduation criteria in the first instance. Before introducing this framework, however, some of the current uncertainties and ambiguities about the smooth transition mechanism will be reviewed in brief.

One of the contentious issues about the smooth transition mechanism is the lack of predictability. To date, there are no formal and binding procedures for smooth transition that are applicable to all ISMs across the board. Only a limited number of ISMs are granted automatically after graduation. These include: (i) duty-free-quota-free market access to the European Union (EU) market under the "Everything But Arms" (EBA) provision, which is provided automatically for three years after graduation; (ii) technical support by the Enhanced Integrated Framework (EIF) for five years; and (iii) travel support to attend UN-related events for three years. To extend other ISMs, each graduated country must negotiate on a case-by-case basis with relevant development partners. In practice, therefore, the extent to which LDCs can maintain access to the relevant ISMs depends on their ability and capacity to undertake bilateral and multilateral negotiations with development partners. Not only does this makes the smooth transition process unreliable and non-transparent but it contributes to diverting the scarce institutional resources of graduating countries from being used to accelerate their 'graduation with momentum'.

As already noted, concerted efforts are now being made by graduating LDCs to secure guarantees from development partners, particularly the WTO, on the extension of trade-related support measures after graduation. The LDC Group at the WTO submitted two draft resolutions for adoption. Tabled in October 2020, the first proposal addressed to the TRIPS Council for adoption foresees that, "A least developed country Member shall not be required to apply the provisions of the Agreement (…) for a period of twelve years from the date of entry into force of a decision by the UN General Assembly to exclude the Member from the least developed country category" (IP/C/W/668). The second broader proposal was submitted to the General Council of the WTO in November 2020, for adoption by the Twelfth Ministerial Conference of the WTO (Geneva, Switzerland, November 2021). It foresees that, "Support measures available to least developed countries shall be extended to a least developed country Member for a period of twelve years after the entry into force of a decision of the UN General Assembly to exclude the Member from the least developed country category" (WT/GC/W/807).These efforts have not borne fruit up to now[14].

14 As discussed above, in November 2020, the LDC group in Geneva submitted a proposal to the WTO on the timeframe for smooth transition strategy requesting the forthcoming WTO Ministerial Conference to make the smooth transition arrangement more predictable by allowing graduated LDCs to continue to benefit from WTO-related support measures, particularly the TRIPS waiver and several other SDT provisions. The WTO General Council considered this proposal but could not reach a decision. The LDC group intends to continue to pursue the matter in WTO in the hope that progress will be made before the next WTO Ministerial conference. One of the contentious issues is the LDC request for a smooth transition period of 12 years.

Another contentious issue is the smooth transition timeframe, which currently ranges between 3 to 5 years. It is not clear how an extension of ISMs from 3 to 5 years after graduation will make a big difference to a country that has already had access to such measures for decades before graduation but failed to make effective use of them. Most LDCs are not able to take advantage of opportunities offered by ISMs due to weak productive capacities. It is highly unlikely, therefore, that prolonging their access to ISMs for an additional 3-5 years after graduation will accelerate a country's growth and transformation, unless, of course, the graduation strategy is designed to strengthen a graduated country's productive capacities. This clearly for a serious rethink of the concept of smooth transition itself, as well as the timeframe for the implementation of smooth transition strategies.

Confusion also exists as to when the preparations for smooth transition strategies should begin. In the past, a graduating country started thinking about a smooth transition strategy after the country was recommended for graduation by the UNGA. However, in 2019, the CDP recommended that a graduating country should not wait for? UNGA's recommendation before starting to prepare a smooth transition strategy. The CDP has proposed that the right time to start preparing the smooth transition strategy is immediately after an LDC meets the graduation criteria for the first time. This paper supports the CDP's proposal, and proposes additional measures that will further improve the timeline for the implementation of the graduation strategy.

As can be seen, ambiguities still exist on the concept of smooth transition and its implementation timeframe. It is therefore important to question the objectives of a smooth transition strategy and address what they seek to achieve. Are they, as currently assumed by the UNGA, the CDP, graduating LDCs and development partners, "to ensure that the phasing out of LDC-specific support does not disrupt a country's development" (CDP, 2020), or are they to build the foundation for a long-term and sustainable development after graduation? If the former, then a smooth transition strategy is essentially a 'transient' (i.e. short-term) measure designed to minimize the disruptive impact of graduation due to loss of LDC-specific ISMs. Unfortunately, the limited objective of a smooth transition strategy will not enable graduating countries to achieve 'graduation with momentum'. To achieve the long-term objective, graduating countries need a 'dynamic' (i.e. broad-based) graduation strategy that expands and strengthens their productive capacities, and which enables them to catch-up and better integrate into the global trading system without the need for special ISMs. This paper argues that graduation strategies should be about catching-up and boosting the productive capacities of graduating countries to graduate with momentum and enable them to stay on a sustainable development path after they leave the category.

V. Narrowing or Closing the Development Gap through Catching-up

A Framework for a Graduation with Momentum Strategy: Going Beyond the First Milestone

A. Catching-up as a development strategy

This section proposes a policy framework that graduating LDCs can apply when preparing their graduation strategies. The framework is based on the premise that closing the income gap with relatively more developed countries and catching up in technological and governance capabilities will enable countries to move up the development ladder[15]. While the full history of the theory of "catch-up" development is beyond the scope of this document, it is worth noting that such theories have been an integral part of the debate on economic development.

Indeed, history is full of examples of countries aspiring to catch-up with more developed countries, and advancing their development by copying policies and strategies from forerunners and learning from each other (O'Rourke and Williamson, 2017). However, it is important to distinguish between the lessons can be drawn, and how they can be applied in different contexts to positive effect. In the 50 years of its existence, UNCTAD has articulated the development challenges facing latecomers (e.g. LDCs) to industrialization, and the development path that they need to follow to close the income and development gaps with more developed economies. An often overlooked key question is why it is so rare to find LDCs catch-up with ODCs and developed economies.

Broadly speaking, economists define catch-up as "the narrowing or the closing of a firm's or country's gap vis-à-vis a leading country or firm" (Lee and Malerba, 2018, p.24). Indeed, historically, the aspiration or vision to catch-up with countries or firms that are relatively more developed, or higher up in the development ladder, has been a powerful motivating force in moving countries and firms forward in the development process (Nayyar, 2013; Chang, 2003). Leading economists in the post-WWII period have argued that there are advantages in being a latecomer because of the ease with which countries can learn from forerunners and catch-up by leapfrogging and emulating policies and development strategies (Gerschenkron, 1962). Whether 'latecomer advantage', as Gerschenkron called it, work in all cases is difficult to say, although it seems to have been effective in the development of some of the newly industrialized East Asian countries (Amsden, 2001).

Evidence exists to show how England's diversification into manufacturing sector, which dates as far back as the 15th century, was driven by the ambition of catching-up with the

15 For a comprehensive analysis of "catch-up" development, see Nayyar (2013) and for a recent analysis of catch-up experiences, see Lee (2018).

16 See Chang (2003) and O'Rourke & Williamson (2017).

manufacturing capabilities of the Low Countries (modern day Netherlands and Belgium)[16]. In pursuing trade and industrial policies, including setting high tariffs on exports of raw wool and sending missions to the Low Countries to "poach skilled workers" over the span of a few decades, England was able to develop woollen-manufacturing capability and transform itself into a major exporter of woollen products (Chang, 2003). Similarly, the industrialization of the United States three centuries later was inspired by a desire to catch-up with European nations through policies that protected local 'infant industries', as well as by acquiring technologies, new skills and learning from the development experiences of the leading countries of the period (O'Rourke and Williamson, 2017; Chang, 2003).

An abundant body of literature exists on development catch-up and why some countries catch up faster, while others fail and remain locked in low-value, low-productivity and low-technology production traps (Abramovitz, 1986; Nayyar, 2013). Evidence from the development experiences of latecomers in Europe in the 18th and 19th centuries (List, 1956; Nayyar, 2013), the process of catching-up by Japan during Meiji period (Ohno, 2019), the East Asian industrialization and rapid catching-up in mid-20th century (Amsden, 1989), and more recently by China (Lin & Zhang, 2019) and Viet Nam (Ngo, 2005) show that countries move up the development ladder by aspiring to catch up with those ahead of them in the development process. However, catching-up does not simply entail copying or cloning the policies, technologies and sectoral priorities of other more developed countries (Lee, 2018); neither does it mean that all countries acquiring technology from more developed firms or countries will catch up automatically. It is rather about developing productive capacities, promoting technological learning and building the different competencies that a country needs to produce a diverse range of products and services that are compatible with those produced by leading firms and countries.

B. LDCs and the Catch-Up Ladder or the Catching-up Experience of Developing Countries

The global economic landscape over the past five decades has generally not been favourable for countries trying to catch-up with those ahead of them and to climb the income, technological and the development ladder. Countries can be divided into four categories in relation to income and development gaps and the catch-up ladder[17]:
The first category consists of the most advanced economies, which are ahead of all other countries, both in terms of the development of productive capacities and income level. Catching-up with this group of countries has been extremely challenging for most upper middle-income economies. As noted by Wade (2019), referring to a World Bank

17 It is difficult to neatly categorize countries into separate categories as income and development levels tend to mask variations across countries. Broadly speaking, advanced countries are OECD member countries (although its membership now includes emerging economies, e.g. Mexico, Chile, etc), and whose GDP per capita income is on average above $12,800. Upper middle-income countries are emerging economies that have developed a diverse range of production capabilities, and whose GDP per capita income range from $9,065 to $12,535. Many developing countries, except LDCs, fall into lower middle-income countries with GDP per capita income ranging from $1,036

study, out of 101 countries which the World Bank classified as middle-income countries in 1960, “only thirteen had become ‘high income’ by 2008, almost half a century later.

Of these, four are peripheral Western European countries (Ireland, Portugal, Spain, and Greece); four are categorized as miscellaneous (Equatorial Guinea, Israel, Mauritius and Puerto Rico); and five are located in North-East Asia (Hong-Kong (China), Japan, Republic of Korea, Singapore and Taiwan Province of China)”. In the second half of the 20th century, with the exception of Japan, these countries followed successful export-led industrialization strategies to achieve the development of productive capacities, and promote structural transformation through improvements in productivity and diversification into more dynamic sectors. In short, with the exception of the oil-dependent countries, these high-income countries have successfully narrowed the income and technological gaps with advanced economies and achieved catch-up growth and economic development.

In the second category are a number of upper-middle-income countries that have gone through the initial stages of structural transformation and catch-up by launching resource-based, or sector-driven industrialization, and economic diversification into manufacturing. These are countries that have raised their income and level of development to a higher level compared with other countries in the developing world, although not high enough to enable them to catch up with advanced economies. Examples include, China, Brazil, Argentina, Mexico, Malaysia, Thailand, Turkey and South Africa among others, . These countries still face development challenges, even though they have developed their productive capacities, and are capable of producing goods and services of a similar quality and standards as those produced by advances countries.

In the third category are the lower middle-income countries, which consist of developing countries that have made some initial progress in expanding their productive capacities, and diversifying their economies through import-substituting industrialization anchored mainly in labour-intensive manufacturing activities. However, while these countries have initiated a structural transformation process, they have generally remained stuck in what is referred to as the ‘middle-income trap’. This has meant that they have been unable to catch-up with upper-middle-income economies or upgrade their production and technological capabilities that would have enabled them to close their income and development gap with advanced countries.

Finally, at the bottom of the development ladder are the ‘least developed’ of developing countries[18], which are listed in a special category and recognized by the international community as structurally weak economies with fewer human assets and limited

18 Although some LDCs are categorized as lower-middle-income countries, they have not structurally developed their economies.

development of productive capacities. These are countries whose GDP per capita income is, on average, less than $1,200, are late-latecomers to industrialization and structural transformation, and mostly rely on the production and exports of low-value and low-productivity primary products, and often highly vulnerable to economic and environmental shocks. In short, these are countries that have yet to launch the structural transformation process, and who have yet to move up the value and technology ladder and catch-up with countries that are ahead of them. For this group of countries, moving up the development and income ladder is tantamount to catching-up with ODCs in the lower-middle-income level.

This differentiated performance and catch-up pattern among countries raises important questions: Why do some countries successfully catch-up, while other countries encounter difficulties, or even remain stuck in a low-productivity and low-value production trap? How can LDCs achieve ‘graduation with momentum’ and catch-up with ODCs? What is the role of the smooth transition strategy in this process, and is there a need for a paradigm shift needed in the design and implementation of smooth transition strategies? The next section sheds some light on these questions and provides the key ingredients for a policy framework which graduating LDCs could use in designing a smooth transition strategy. The framework is based on the premise that the development of productive capacities is a key determinant of structural transformation and catching-up.

VI. A New Generation of graduation strategy to achieve ‘Graduation with Momentum’

Graduation from the LDC category is a critical juncture for LDCs, as it signals a departure from the category of the poorest and structurally weakest economies. As new ODCs, graduated countries can engage with other ODCs on the basis of common international rules, regulations and standards. Although graduation can represent a source of pride and achievement for LDCs, the post-graduation transition is filled with uncertainty, anxiety and even stress for governments of graduating countries. As the number of LDCs eligible for graduation increases, substantial evidence is emerging indicating that the transition out of the LDC category and the loss of ISMs can be challenging and demotivating, particularly for countries that have not yet significantly developed their productive capacities. Since its inception, the primary objective of smooth transition strategies has been to create a short-term post-graduation soft-landing, and ease the concerns of countries preparing to engage in international economic relations as non-LDCs. Therefore, as currently devised, the smooth transition strategy is aimed at the post-graduation development trajectories of concerned countries, rather than preparing them for ‘graduation with momentum’.

Building on UNCTAD’s work on graduation, this paper argues that supporting graduated countries by extending the relevant existing ISMs and providing additional country-specific assistance is not only essential for a soft-landing post-graduation, but also needed to achieve sustainable development. Development is not a binary process, neatly divided between pre- and post-graduation development trajectories, but should be seen rather as a continuous process that builds on what has previously been achieved. In other words, post-graduation support measures only become more effective if they build on capabilities and development progress achieved prior to graduation. This allows countries to approach graduation with dynamism and sustained momentum.

In most cases, the challenges that countries face in the post-graduation period are reflections of those that they faced prior to graduation. They carry with them the weaknesses and impediments that characterized their economies during the pre-graduation period, such as underdeveloped productive capacities, lack of dynamic enterprises and infrastructure, limited technological capabilities, and infant or fragile institutions. These are some of the key elements of productive capacities that graduated countries need as non-LDC developing countries to sustain their post-graduation development momentum and move up the value and productivity ladder, and catch-up with ODCs. If some, or all, of these essential elements of productive capacities are not developed before graduation, it is highly likely that the road to sustainable development after graduation will be rough and full of pitfalls.

A new generation of graduation strategies will enable LDCs to achieve ‘graduation with momentum’ through a policy and strategic synergy between the development trajectory prior to graduation, and sustainable development in the post-graduation era. The key feature of these new generation smooth transition strategies is to bridge the pre- and post-graduation development processes to create ‘graduation with momentum’, and continuity in development trajectory beyond graduation. To this end, two key adjustments are proposed to the current conceptualization of smooth transition strategies, namely:

(i) The introduction of a policy framework to help refocus the objectives and strategic direction of the smooth transition strategy; and

(ii) A new timeframe for the implementation of the strategy.

The policy framework is based on ideas and concepts emerging from historical development experiences and the findings of UNCTAD’s analytical work on LDCs, including through its Least Developed Countries Report series. An effective policy framework for designing a development strategy typically requires two elements:

(i) Greater clarity on the development processes that will determine the strategy’s ultimate objectives and strategic direction; and

(ii) A set of key principles and values to define the scope of the strategy and guide its implementation.

A. The Policy Framework for a New Generation of Graduation Strategies

The policy framework for a new generation of smooth transition strategies would be based on the following three historically proven development processes and pathways.

First, the most successful development strategies have been – explicitly or implicitly – driven by the ambition to catch-up with countries ahead in the development process. As already discussed above, the development of all latecomers has been directly or indirectly influenced by the desire (in some cases with intense determination, as in the case of Japan in the post-Meiji era) to catch up with more developed countries (Ohno, 2019). Development strategies based on catch-up provide strategic direction, motivation, targeted benchmarks and clarity on the ultimate goals, regardless whether these to related to catching-up in areas, such as technology, income, level of development of productive capacities, international competitiveness, etc.

When the LDC category was first established in 1971, the implicit (if not explicit) assumption behind the international community’s decision to provide LDCs with targeted support measures was to create a favourable environment to enable LDCs to catch-up with ODCs, and narrow the income and development gap with developed economies. The three criteria initially used to identify the ‘least developed’ of developing countries indicated that LDCs lagged all other countries in terms of: (i) income; (ii) the capacity to mobilize finance; (iii) human capital development; (iv) industrialization; and (v) economic diversification. In principle, therefore, graduation from the LDC category should indicate catching-up and the narrowing of the development gap between LDCs and other countries, for example, in terms of the development of productive capacities. This would reflect their ability to engage in economic interaction with the rest of the world without needing special support measures.

The current graduation criteria do not only measure catching-up but also progress made in improving income, human asset development and economic and environmental resilience. This is so despite the widening development gap – first and foremost in terms of productive capacities – between LDCs and other countries. UNCTAD's Productive Capacities Index (PCI) (UNCTAD, 2020c) has shown that most LDCs are being left behind. The figures in Annex II show that, with the exception of natural capital, which indicates the rich resource endowment of countries, LDCs lag well behind ODCs and developed economies in all the categories of productive capacities in the PCI namely: (i) human capital; (ii) energy; (iii) institutions; (iv) structural change; (v) private sector development; (vi) ICT; and (vii) transport networks.

Building on UNCTAD's proposal for 'graduation with momentum', this paper argues that the main objective of a graduation strategy should be to enable LDCs to catch-up with ODCs, and set in motion a process of continuous economic diversification and structural transformation. To achieve these goals, the core focus of an SGM should be to expand and strengthen the productive capacities of graduating countries. This entails designing graduation strategies as long-term catch-up strategies to build the capabilities that graduating LDCs need to achieve 'graduation with momentum' and catch-up with ODCs.

In pursuing catch-up driven strategies, LDCs should be aware that this process occurs at different levels, e.g. at the firm, sectoral and country levels, and in much the same manner as the process of developing productive capacities. In some countries, successful catch-up has been achieved by developing a sectoral niche or specialization and building on that success – in some cases through technological leapfrogging – to drive catch-up in other sectors or the rest of the economy (Lee and Malerba, 2018). Multiple examples exist of sectoral catch-up leading to accelerated development and catching-up in other sectors or the whole economy. India, for example, has been quite successful in catching-up with leading countries in the IT and pharmaceutical sectors, and is now building on these sectoral capabilities to boost growth and catch-up in related sectors (Barnes, 2018). Similarly, Brazil has been successful in catchin-up in the agro-food industry, although less so in the IT sector (Hubbard, Alvim & Garrod, 2017). Nevertheless, the agro-food industry in Brazil has enabled the country to promote linkages with other sectors, and develop a sophisticated and internationally competitive agro-processing sector.

These examples from lower and upper middle-income countries obscure the fact that catching-up at a sectoral level, while the rest of the economy is lagging. has also been observed in some LDCs, e.g. the tourism sector development in the Maldives and Samoa; the energy sector in Bhutan; and firm/industry-level development and catching-up in the aviation industry in Ethiopia (Oqubay & Tesfachew, 2019). However, it remains to be seen if some LDCs, e.g. Ethiopia, or graduated countries, e.g. Maldives and Samoa, will be able to leverage this sectoral specialization to achieve national level catch-up. As Lee and Malerba (2018) reminded us, “while catching-up at all levels is good, what is important is whether countries are catching-up at the national level”. Thus, ultimately, expanding productive capabilities across the whole ecosystem is the preferred route towards successful catch-up.

Second, catching-up at a national level is measured by the degree to which a country moves up the value chain through diversification into high-productivity sectors or activities, and by upgrading its technological capabilities, as well as increasing the sophistication of its production and export structure. Moving in these directions enables a country to produce a diverse range of increasingly more complex and knowledge-intensive products and services, both for domestic consumption and for export. In short, catching-up involves a process of structural transformation in which a country’s production structure moves progressively up the productivity ladder, and starts to generate well-paying jobs and create the conditions for increased prosperity and access to public goods, such as superior health services and education – all critical to human development and social equity. Over the years, UNCTAD has consistently advocated for LDCs to place the fostering of structural transformation at the heart of their national development agendas. For example, since 2013, UNCTAD has consistently shown through its annual Least Developed Countries Report that the intrinsic and indivisible links between structural transformation and the creation of decent and well-paying jobs for the millions of young people in LDCs who join the labour market every year (UNCTAD, 2013); the achievement of the 2030 Agenda for Sustainable Development and the SDGs (UNCTAD, 2014); the transformation of LDCs’ rural economies (UNCTAD, 2015); graduation from the LDC category (UNCTAD, 2016); the generation of transformational energy capacity (UNCTAD, 2017); the deepening of entrepreneurship capabilities (UNCTAD, 2018); the effective utilization of development finance (UNCTAD, 2019); and the development of productive capacities (UNCTAD, 2020b). In this body of analytical work, UNCTAD has consistently pointed to productivity improvements and the development of productive capacities as central to the process of structural transformation.

Traditionally, structural transformation has been associated with the shift of production systems from agriculture, which tends to be characterized by low-productivity and low-value farming activities, towards the industrial sector, particularly manufacturing (UNCTAD, 2014). Manufacturing is often singled out as the most dynamic sector for fostering successful structural transformation, especially in the earlier stages of development. As highlighted by UNCTAD, the appeal of manufacturing as an important driver of structural transformation is related to two factors: first, its propensity to induce continuous upgrading of productive capacities, leading to productivity gains through entry into new areas of economic activity; and second, its propensity to: (i) create better paying jobs (at least compared to agriculture); (ii) prompt the application of more advanced technologies; and (iii) allow the production of higher-value goods that can be exported through international value chains (UNCTAD, 2020a).

Structural transformation not only engenders shifts between and within sectors but also facilitates the move towards more knowledge-intensive activities generating higher value-added. As observed by UNCTAD, “The divisions between broadly defined sectors (agriculture, extractive industries, manufacturing and services) mask enormous differences within each sector — from small subsistence farms to plantations, from artisanal mining to oil rigs, from a person with a sewing machine to a textile factory, from a street seller to a software consultant. Thus, differences in productivity within each broad sector may be as great as those between sectors. Therefore, the understanding of structural transformation can be extended to include not only shifts between sectors, but also within sectors, towards activities which are more knowledge-intensive or have higher value added or greater learning potential” (UNCTAD, 2014, p.51).

It is evident from these descriptions of sectoral features that structural transformation can be fostered not only through the traditional channel of shifting resources from agriculture to manufacturing, but also by generating more dynamic, higher productivity and higher value-added activities within sectors, such as services or the extractive sectors. This characterization of the structural transformation process is important for LDCs, particularly as small economies lack large domestic markets, nor are afforded the opportunity to follow the traditional approach to structural transformation. Small graduating LDCs should diversify into higher productivity and higher-value service activities as they formulate their graduation strategies. Equally, graduating countries endowed with natural resources and which rely on production and export of primary products for economic growth, should pursue the structural transformation agenda by exploring options to move up value chains through backward and forward-linkages and greater processing of primary products.

Finally, the key requirement for fostering structural transformation and catching-up is the development of productive capacities. Productive capacities are the diverse competencies, resources, skills, infrastructure, technological capabilities, institutions and knowledge systems which a country needs to progressively produce more sophisticated goods and services efficiently and competitively. The question of how productive capacities develop and the mechanisms through which they become instruments of structural transformation and catching-up are discussed below. Suffice it to say at this point that the development of productive capacities and the policy environment that fosters it have been the key forces driving structural transformation and catch-up in cases where this has been achieved. As UNCTAD has noted in a recent publication, “The economic development of a country is the result of two main interconnected processes: productive capacity-building and the structural transformation of the economy” (UNCTAD, 2020a). Based on this logic, UNCTAD has consistently argued that the challenges faced by LDCs are rooted in the limited development of their productive capacities, and their failure to improve on existing productive capacities or to utilize them (however limited) effectively (UNCTAD, 2020a).

Building on this UNCTAD assessment of the root causes of the problems faced by LDCs, this paper proposes that the framework for organizing an SGM should be based on: **(i) expanding productive capacities; (ii) fostering structural transformation; and (iii) catching-up with ODCs.** A smooth transition strategy built around this framework would enable graduating countries to achieve ‘graduation with momentum’. A starting point for strategies based on this framework is the development of productive capacities, which determines both the depth of the structural transformation that a country can achieve and the prospect for catching up. This framework could have shaped development trajectories of LDCs and the objectives of ISMs from the inception of the LDC category in 1971. Unfortunately, this did not occur and has consequently resulted in the international community now confronted with a situation in which an increasing number of LDCs are graduating before they are able to develop their productive capacities and catch-up with competitor countries in the developing world. This explains the fear and anxiety on the post-graduation challenges faced by LDCs, and the persistent demand for the extension of LDC-specific ISMs after graduation.

These apprehensions will become even more intense as the composition of the LDC group changes in the near future. Other than Angola and Sao Tome and Principe, all the countries that are expected to graduate in the coming 5-7 years are from the Asia and Pacific region. This will change the nature and composition of the LDC category significantly. In the near future, the group will become more geographically homogeneous (i.e. concentrated in Africa), and will consist of countries that are considerably poorer and exhibit more features associated with earlier stages of development, such as: (i) weak productive capacity; (ii) larger shares of agriculture in output and employment; (iii) severe structural impediments; (iv) higher export concentration (especially in commodities); (v) greater aid dependency; (vi) more limited access to social services; and (vii) weaker institutional development. In addition, these countries are lagging behind in meeting the graduation criteria, and made very little progress in their economic and social development over the past four decades. Consequently, they are unlikely to achieve 'graduation with momentum', unless bold and decisive measures are taken to help them expand their productive capacities, structurally transform their economies, and enable them to catch-up with other more dynamic developing countries.

B. Key Principles and Values Underpinning the SGM

This section outlines the key principles and values on which the SGM should be based and the spirit in which they should be implemented. To this end, the following five key principles and values will need to be upheld.

First, it is important to view graduation "as the first milestone in a marathon of development rather than the winning post in a race to escape LDC status" (UNCTAD, 2016, p.162). Development partners must realize that becoming eligible for graduation does not necessarily mean that graduating countries no longer need international support, or that the existing support measures can be withdrawn immediately. To the contrary, it is vital that support measures are extended for a reasonable period of time after graduation to ensure a smooth landing, and allow these countries to adjust to their new position. Moreover, when a country graduates from the LDC category, the credit for this success belongs not only to the country itself but also to the development partners who assisted its efforts to graduate through LDC-specific ISMs. In this regard, graduation is a shared objective, and its achievement ultimately reflects the fulfilment of commitments made by the international community. Importantly, development partners should see the process to the end by ensuring that LDCs not only achieve graduation but also continue to grow and catch-up, rather than fall back, or regret graduating because of the hasty withdrawal of ISMs.

Second, the development of productive capacities is the key driver of 'graduation with momentum', catching-up with ODCs and sustainable growth after graduation. LDCs that graduate without having first strongly expanded their productive capacities will continue to face serious impediments to growth and structural transformation and will continue to lag behind, even after graduation from the LDC category. Therefore, the central objective of a new SGM should be to expand and strengthen the productive capacities of graduating countries by assessing each graduating country's strengths and weaknesses, and designing a productive capacity development strategy that matches its specific needs and conditions. To this end, the following processes and procedures will be needed:

A Productive Capacity Gap Assessment (PCGA) based on UNCTAD's Productive Capacity Index (PCI) should be conducted to:

i. Establish the level of development of the productive capacity of the graduating country and the gap with ODCs, using, for example, lower middle-income countries as a benchmark. The PCI is designed to benchmark the development of a country's productive capacities. This makes it an effective tool in assessing whether a graduating country is catching-up, and which aspects of its productive capacity building is advancing or lagging;

ii. Review the variations in the degree of development among the different components of productive capacities, as defined by the eight categories identified in the PCI, namely natural capital, human capital, institutions, structural change, energy, private sector development, ICT ecosystem and transport. The objective of this exercise is to gauge whether any progress has been made in productive capacity building is compatible with a country's comparative advantage and sectoral specialization, as well as serve to investigate the main root causes of a country lagging behind in different domains;

iii. Recommend specific areas of productive capacities which benefit from international support and priority attention in their SGM. As explained in Section V below, the development of productive capacities involves the expansion of a wide range of capabilities, infrastructure, competencies and skills. LDCs may not be able to develop all of these at the same time or at the same rate. The question, therefore, is whether a graduating country is developing the specific productive capacities to enable it to exploit its comparative advantage, achieve growth, and competitively engage in the international trading system. Bhutan, which specializes in export of energy, requires qualitatively different productive capacities to sustain its growth momentum and post-graduation sustainable development than Kiribati, a small island economy dependent on tourism.

APCGA would allow the identification of the specific areas of productive capacities that required urgent attention as part of a new graduation strategy.

iv. Identify domestic policies and specific ISMs – both from the existing ISMs and additional targeted support measures tailored to the individual graduating country – that should be incorporated into the smooth transition strategy. Given the heterogeneity of LDCs, a one-size-fits-all approach will not be appropriate for policies to develop productive capacities. Thus, an SGM should give greater attention to policies and institutions that will enable the graduating country to expand and/or strengthen its productive capacities in accordance with its comparative advantage, and allow it to maximize the benefits from its advantages, achieve 'graduation with momentum' , and continue to grow and catch-up with ODCs, even after graduation.

Prepare the SGM based on the framework proposed in this document, to include the findings of the PCGA, DESA's Impact Assessment (IA), and UNCTAD's Vulnerability Profile (VP) report. Both the IA and VP reports are mandated by the UNGA and would serve, along with the results of the PCGA and policy framework proposed in this document, as the bases for formulating a country's strategy for 'graduation with momentum'. Unlike the current practice, whereby the smooth transition period starts after graduation, the implementation of the SGM would start in the first year after the CDP establishes that a country meets the graduation criteria for the first time. This would focus largely on the expansion of productive capacities and preparing the graduating country for 'graduation with momentum'. This approach introduces two new elements to the formulation and implementation of the SGM.

The preparation of such a strategy should be fast-tracked, and preparations and implementation should start immediately after the country meets the graduation criteria for the first time. Only one country – Vanuatu – has prepared a smooth transition strategy, which suggests that either other graduating countries are not taking the smooth transition strategy seriously, or there is a confusion on the process and timing.

Extending the preparatory period after meeting the criteria for the second time to 5 years from the current 3 years, should be sufficient to ensure that graduating countries have enough lead time to prepare for 'graduation with momentum' by strengthening their productive capacities. Such an extension would not be unusual: it has become increasingly common to extend the preparatory period following a CDP recommendation on graduation from 3 to 5 years for countries experiencing challenges, either because of natural disasters or other shocks, e.g. global crises and pandemics. Standardizing a 5-year preparatory period would require a UNGA resolution, and the request for such an adjustment should be tabled at the Fifth United Nations Conference on LDCs in Doha in January 2022. Following the example set by the Enhanced Integrated Framework (EIF), the smooth transition period after graduation should be extended to minimum of 5 years. As already noted above, the principle of a smooth transition period is widely accepted, and the UNGA has requested development partners to implement it and make it predictable. If all bilateral and multilateral development partners offered a 5-year post-graduation transition period, along with a 5-year pre-graduation preparatory period, a graduating country would have at least a decade to implement its SGM. If an SGM was prepared within a year of a country meeting the graduation criteria for the first time, the graduating country would have a total of 12 years to build its productive capacities. The SGM would thus become an instrument for both ‘graduation with momentum’ and a smooth transition and sustainable development following graduation.

Monitoring the development of productive capacities in graduating and graduated countries through the PCI would enable to assess progress in fostering structural transformation and catching up with ODCs. Monitoring progress in the implementation of an SGM could be aligned with the existing enhanced monitoring mechanism applied by the CDP when it reviews the performance of graduating and graduated countries.

VII. Conclusion

This paper advances two core arguments: first, the need for a rethinking of the objectives and the implementation timeframe of an SGM. It argues that objectives of this strategy should be transformed from its current perspective as a 'transient' post-graduation measure to extend existing ISMs for a short period into a 'long-term and broad-based strategy aimed at supporting the aspiration of graduating countries to achieve what UNCTAD calls 'graduation with momentum' . Second, the paper argues that the key to achieving 'graduation with momentum' is to develop productive capacities, which are also the main drivers of structural transformation, and the ability of countries to catch-up with other countries higher up in the development ladder.

To date, six countries have graduated from the LDC category and about 11 additional countries are expected to graduate in the coming few years. The countries that have graduated so far have not met the third and most difficult graduation criteria – economic and environmental vulnerability. The latter includes indicators that require countries to build resilience and the capacity to increase productivity in agriculture and diversify into manufacturing, broaden the export base, and create stability in export performance and earnings. These are features that can only be acquired by developing productive capacities, as well as by being able to shift resources (capital and labour) from primary to secondary sectors, or from low-value to high-value activities. It is not surprising, therefore, that the first country to graduate from the LDC category after having met all the three criteria well above the required threshold for graduation will be Bangladesh – a country that has made significant progress in developing productive capacities. For the last 30 years, Bangladesh has pursued an export-led industrialization strategy, anchored in the manufacturing sector, and has emerged as a leading exporter of ready-made garments. While this sector accounts for the bulk of the country's manufactured exports, Bangladesh has also diversified into other industries, especially the pharmaceutical industry. This is another hallmark of its efforts to develop productive capacities.

However, as more and more countries meet the criteria for graduation, a new and worrying phenomenon has emerged. Graduating countries are increasingly anxious that the loss of LDC-specific ISMs will disrupt their development and escalate the risk of being locked in the low-middle income trap. As countries leave the LDC category, this 'fear of the unknown' is testing the confidence of graduating countries and leading them to delay graduation. The possibility that some graduated countries could fall back into the LDC category when ISMs are withdrawn supports the need for a transitional arrangement after graduation, and the introduction of the smooth transition strategy as a time-bound and short-term measure to provide a soft landing after graduation. Various UNGA resolutions have called for effective smooth transition measures but the smooth transition process remains unpredictable and difficult to implement. This paper has attempted to unravel the limitations in the current conceptualization of a smooth transition strategy, and provides an alternative policy framework and timeframe to reconfigure it as a long-term development strategy for developing the productive capacities of graduating countries.

The premise behind the proposed paradigm shift is the conviction that, in the long term, how a country graduates is as important as when it graduates. The primary goal should not be graduation per se but 'graduation with momentum' , which would allow the development trajectory to be maintained and pitfalls to be avoided far beyond graduation. Following this logic, the paper proposes the following three important steps in the preparation and implementation of a new generation smooth transition strategy.

First, the graduating country should conduct a Productive Capacity Gap Assessment (PCGA) within one year of the country meeting the graduation criteria for the first time. The outcome of this PCGA should form the basis on which the smooth transition strategy is formulated, along with evidence gathered through the IA and VP reports.

Second, the policy framework for designing an SGM should be based on the development of productive capacities and the process of structural transformation, which are both essential for graduating countries to catch-up with ODCs.

Third, the extension of both the preparatory period after the UNGA's recommendation for graduation and the transition period after final graduation to 5 years[19]. Assuming that the SGM is prepared on the basis of the PCGA, IA and VP reports within a year after meeting the criteria for the first time, the graduating country will have a total of 12 years to expand its productive capacities and catch-up with ODCs. These scenarios will enable graduating countries to achieve 'graduation with momentum', and make it possible to for for the post-graduation development process to be sustainable, and would furthermore avoid graduated countries falling into the low-middle-income trap.

19 Currently, the standard preparatory between the UNGA's decision to graduate a country and the country's removal from the LDC category is 3 years but the UNGA has in a number of cases, e.g. Vanuatu, Bhutan, etc., given a 5-year preparatory period on an exceptional basis. Similarly, the EU and the UN provide a standard 3-year transition period after graduation, although the EIF has extended the smooth transition period for 5 years. Therefore, introducing a standard 5 years for both the preparatory period before graduation and another 5 years after graduation would not be out of the ordinary.

Annex

Annex I: Ministerial Declaration of the Least Developed Countries, New York, 26 September 2018 (excerpt)

47. We therefore call upon the Member States to agree on a package of benefits from development partners that the graduated countries will continue to enjoy in some critical areas of their economy for a certain period of time consistent with their development situations and needs. This can serve as a safeguard measure for the graduated countries to sustain their development path and not to relapse to the category of LDCs, thereby facilitating the achievement of the SDGs by 2030. This may include:

a) Support to graduating countries in costing, mobilizing resources and monitoring the implementation of the SDGs, covering all 17 Goals.

b) More in-depth analysis of the potential impacts of graduation and identification of additional support to address the challenges of graduation.

c) Capacity-building support to enhance access to new sources of financing, including blended financing of domestic and international resources.

d) Facilitating increased access to other means of financing, including private finance, green bond financing and GDP-indexed bonds. Credit ratings and risk management measures, including through the Multilateral Investment Guarantee Agency, could be helpful in this respect.

e) Bringing together various stakeholders, including development and trading partners and the private sector to provide a platform for countries about to graduate to showcase progress and investment opportunities, for example an improved business environment and increased institutional capacity.

f) Extension of the preparatory period to five years from the current three years before effective graduation in order to anticipate and adapt to the trade-related effects of preference loss with a view to providing greater flexibility, for example to ensure workers are retrained and can achieve productivity gains to counteract any adverse effects related to increased competition.

g) Legal assistance to transition from the EU's Everything But Arms to the enhanced Generalized Scheme of Preferences to mitigate abrupt loss of preferences as the GSP+ offers an additional preference (in some cases comparable with the EBA).

h) A transitional services waiver arrangement: The LDC services waiver is a new mechanism made available to and yet barely utilised by the next wave of graduates. Given the importance of services to trade nowadays, as organised within GVCs, a particular transitional arrangement could be secured for forthcoming graduates from LDC status for this preference.

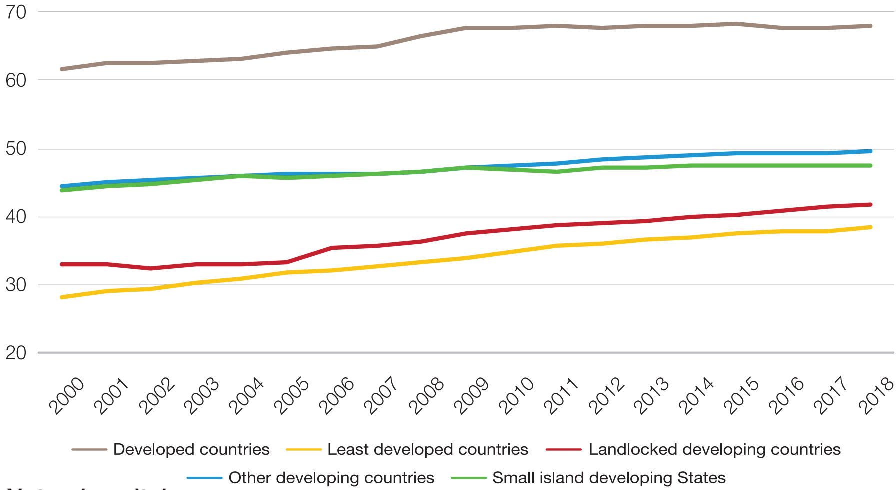
i) More targeted Aid for Trade support: To improve the effectiveness of Aid for Trade disbursements pre- and post-graduation, the GVC approach towards assessment of needs for trade-related adjustment must be adopted. Investments in infrastructure can further reduce trade costs in view of heightened competition after graduation.

j) Enhanced technical assistance to LDCs to build and strengthen their intellectual property rights systems would enable them to comply with obligations related to intellectual property after graduation. The implementation of the intellectual property regime should be an integral part of the national smooth transition strategy, taking into account national circumstances, and assistance in this regard should be extended to the graduating country at an early stage;

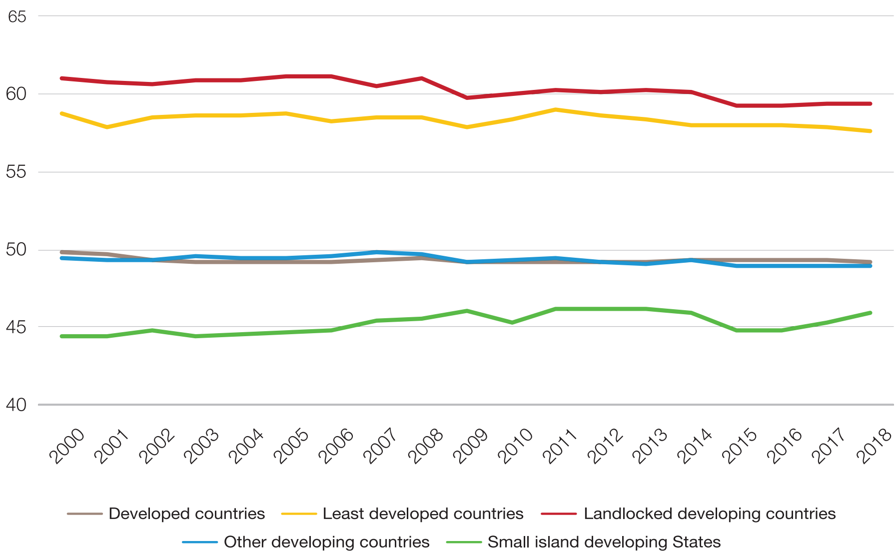
Source: Ministerial Declaration of the Least Developed Countries, New York, 26 September, 2018

Annex II: Evolution of PCI, by Category

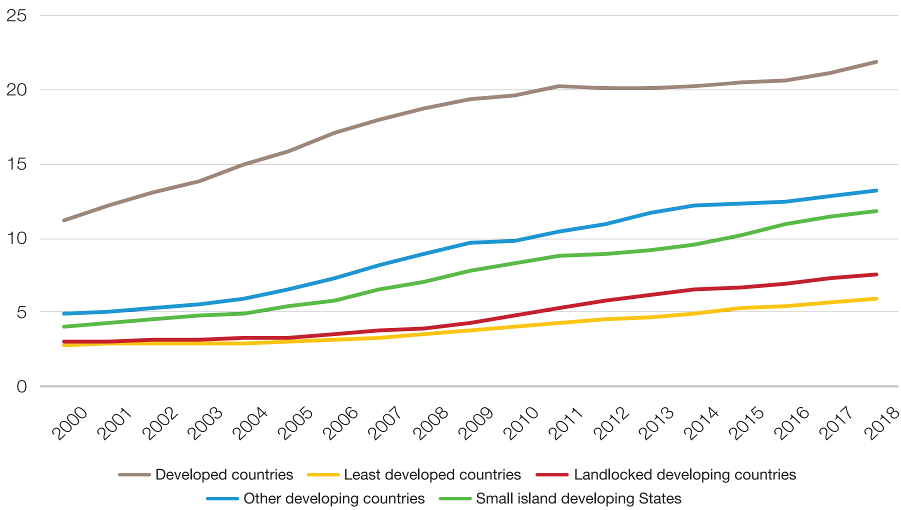
Human capital



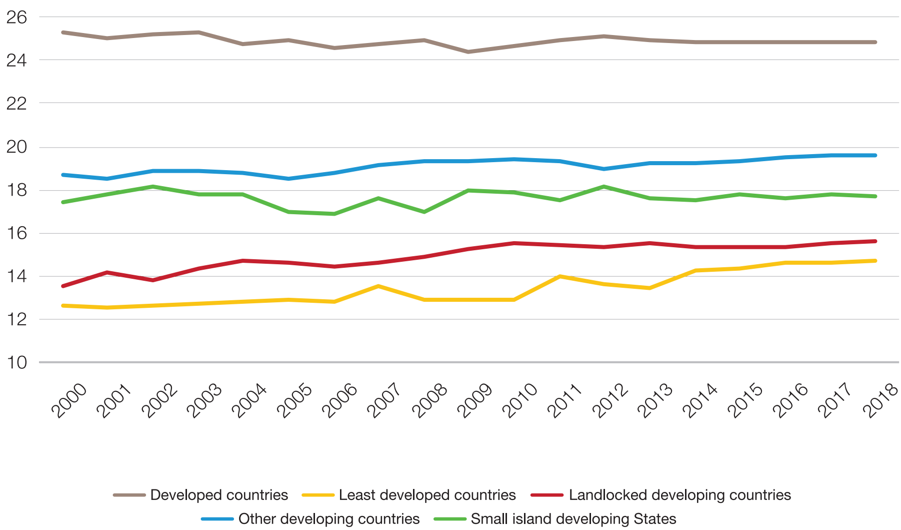
Natural capital



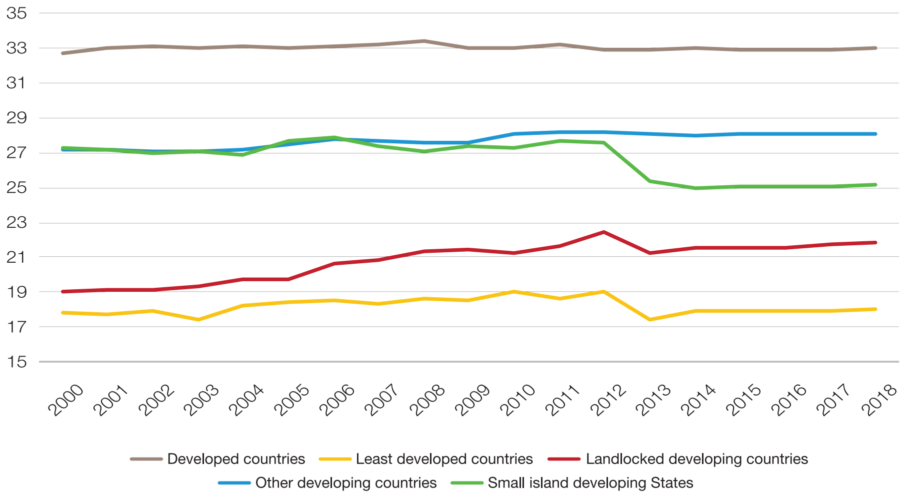
Information and communications technology



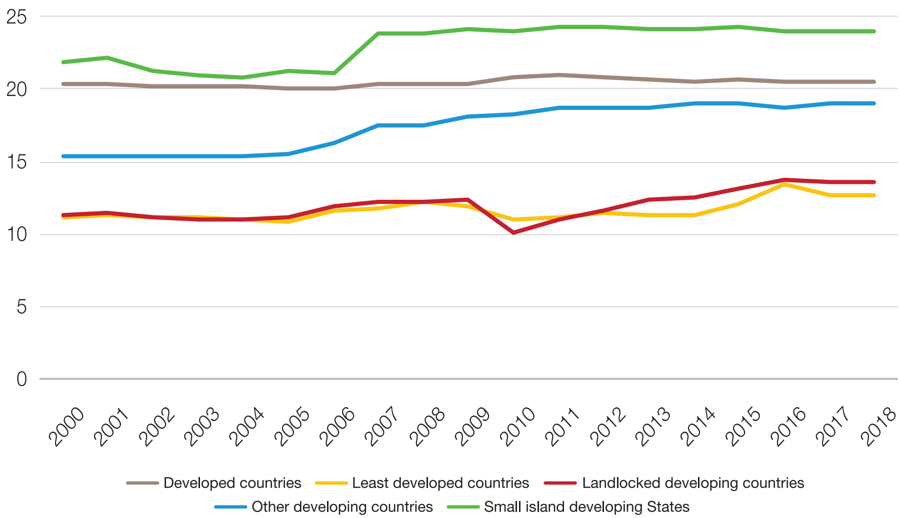
Structural change



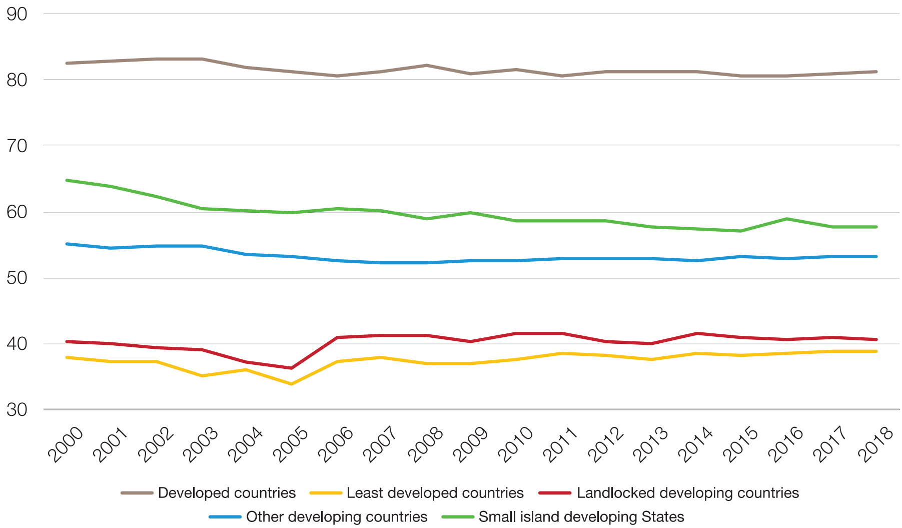
Energy



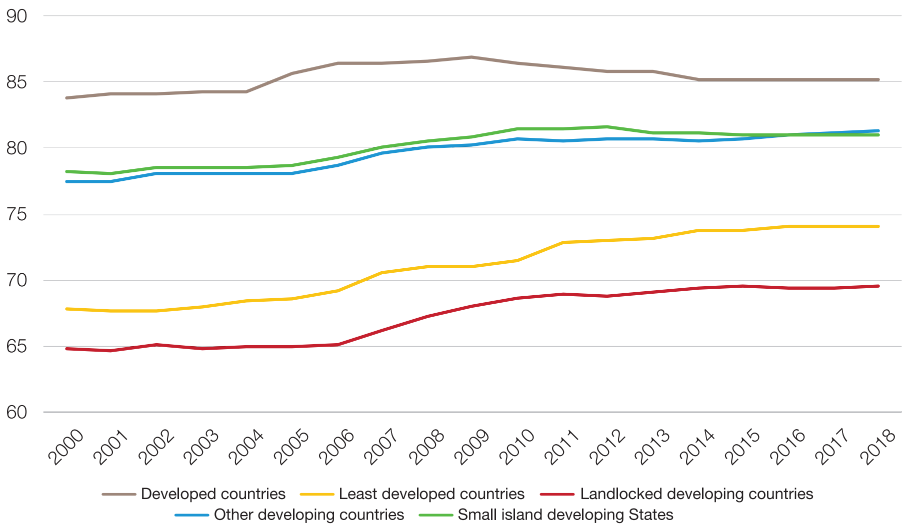
Transport



Institutions



Private sector



Source: UNCTAD (2021). UNCTAD Productive Capacities Index: Methodological Approach and Results. Geneva: United Nations. UNCTAD/ALDC/2020/3.

References

Agenor, Pierre-Richard (2017). Caught in the Middle? The Economics of Middle-Income Traps. Journal of Economic Surveys. (31)3:771-791.

Abramovitz, M (1986). 'Catching Up, Forging Ahead and Falling Behind', Journal of Economic History. XLVI (2): 385-406.

Amsden, A (2001). 'The Rise of the Rest': Challenges to the West from Late-Industrializing Economies. Oxford: Oxford University Press.

Amsden, A (1991). Diffusion of Development: The Late-Industrializing Model and Greater East Asia, The American Economic Review, Vol. 81 (2) 282-286.

Barnes, T (2018). "The IT Industry and Economic Development in India: A Critical Study", Journal of South Asian Development. 8(1):61-83.

CDP (2017). "Expanding productive Capacity: Lessons Learned from Graduating LDCs", CDP Policy Note.

Chang, H-J (2003). Kicking Away the Ladder: Development Strategy in Historical perspective. London: Anthem Press.

Fialho, D (2011). Aiming High, Falling Short: The Least Developed Country (LDC) Category at 40 (June 14, 2011). CERES Summer School, 2011, Available at SSRN: https://ssrn.com/abstract=1860098

Fialho, D (2015). Slicing up the Developing World: Differentiation in the Special Treatment of Developing Countries. PhD Thesis, Erasmus University Rotterdam.

Gay, D (2017). "From planning to policy: Half a century of the CDP," CDP Background Papers 036, New York, UN DESA.

Gay, D (2017). For the least developed countries, revitalising multilateralism is life or death. Available at: https://emergenteconomics.com/page/2/.

Glawe, L & Wagner, H (2016). The Middle-Income Trap – Definitions, Theories and Countries Concerned: A Literature Survey, Rochester, SSRN.

Hubbard, C, Alvim, M & Garrod G (2017). "Brazilian Agriculture as a Global Player", EuroChoices. 16 (special edition): 3.

Lee, K (2013). Schumpeterian Analysis of Economic Catch-up: Knowledge, Path-Creation and the Middle Income. Cambridge: Cambridge University Press.

Lee, K & Malerba, F (2018). ‘Economic Catch-up by Latecomers as an Evolutionary Process’, in (eds) Nelson, R, Modern Evolutionary Economics: An Overview. Cambridge: Cambridge University Press.

Lin, J and Zhang, J (2019). China: Learning to Catch-up in a Globalized World, in Oqubay, A & Ohno, K (eds), How Nations Learn: Technological Learning, Industrial Policy, and Catch-Up. Oxford: Oxford University Press.

List, F (1956). National System of Political Economy, Vols I-IV. Memphis, TN: Lippincott.

Ohno, K (2019). Meiji Japan: Progressive Learning of Western Technology, in (eds) Oqubay, A & Ohno, K, How Nations Learn: Technological Learning, Industrial Policy, and Catch-Up. Oxford: Oxford University Press.

Oqubay, A & Tesfachew, T (2019). “The Journey of Ethiopian Airlines: Technological Learning and catch-up in Aviation”, in (eds), Oqubay, A & Ohno, How Nations Learn: Technological Learning, Industrial Policy, and Catch-up. Oxford University Press. Oxford. UK

O’Rourke, K., and Williamson, J. eds. (2017). “The Spread of Modern Industry to the Periphery since 1871”. Oxford University Press. Oxford. UK

Gerschenkron, A (1962). Economic Backwardness in Historical Perspective. Cambridge, MA: Harvard University Press.

Glawe, G and Wagner, H (2016). “The Middle-Income Trap – Definitions, Theories and Countries Concerned: A Literature Survey”, Munich Personal RePEc Archive, MPRA paper No. 71196.

Nayyar, D (2013). Catch-Up: Developing Countries in the World Economy. Oxford: Oxford University Press.

Ngo, T.H (2005). Catching-UP Industrial Development of East Asian Economies and Its Application to Vietnam. Journal of Development Areas. 39(1): 71-98.

Prebisch, R (1964). Towards a New Trade Policy for Development. Report by the Secretary-General of the United Nations Conference on Trade and Development (UNCTAD). UN: Publiction. Sales No. 64: II: B.4. NY.

UN-DESA (2021). World Economic Situation and Prospects 2021. UN: New York.

UN-DESA (2020). “Smooth Transition Strategy: Template and Guidance Note”. UN: New York.

UNCTAD (1970). “Special measures in favour of the least developed among developing countries”, (TD/B/288). UN publication, Sales No. E.71.ILD.I.

UNCTAD (1985). The History of UNCTAD: 1964-1985. UN. Geneva.

UNCTAD (2006). The Least Developed Countries Report 2006: Developing Productive Capacities. United Nations publication. Sales No. E.06.II.D.9. New York and Geneva

UNCTAD (2010). The Least Developed Countries Report 2010: Towards a New International Development Architecture for LDCs. United Nations publication. Sales No. E.10.II.D.5. New York and Geneva.

UNCTAD (2013). The Least Developed Countries Report 2013: Growth with Employment for Inclusive and Sustainable Development. United Nations publication. Sales No. E.13.II.D.1. New York and Geneva.

UNCTAD (2014). The Least Developed Countries Report 2014: Growth with Structural Transformation – A Post-2015 Development Agenda. United Nations publication. Sales No. E.14. II.D.7. New York and Geneva.

UNCTAD (2015). The Least Developed Countries Report 2015: Transforming Rural Economies. United Nations publication. Sales No. E.15.II.D.7. New York and Geneva.

UNCTAD (2016). The Least Developed Countries Report 2016: The Path to Graduation and Beyond: Making the Most of the Process. United Nations publication. Sales No. E.16.II.D.9. New York and Geneva.

UNCTAD (2017). The Least Developed Countries Report 2017: Transformational Energy Access. United Nations publication. Sales No. E.17.II.D.6. New York and Geneva.

UNCTAD (2018). The Least Developed Countries Report 2018: Entrepreneurship for Structural Transformation: Beyond Business as Usual. United Nations publication. Sales No. E.18.II.D.6. New York and Geneva.

UNCTAD (2019). The Least Developed Countries Report 2019: The Present and Future of External Development Finance – Old Dependence, New Challenges. United Nations publication. Sales No. E.20.II.D.2. New York and Geneva.

UNCTAD (2020a). Building and Utilizing Productive Capacities in Africa and the LDCs: A Holistic and Practical Approach. UNCTAD: Geneva, Switzerland.

UNCTAD (2020b). The Least Developed Countries Report 2020: Productive Capacities for the new Decade. Sales No. E.21.II.D.2. New York and Geneva.

UNCTAD (2020c). UNCTAD Productive Capacities Index: Methodological Approach and Results. UNCTAD, Geneva.

UNCTAD (2021). UNCTAD’s Productive Capacities Index: Methodological Approach and Results. Geneva: United Nations. UNCTAD/ALDC/2020/3.

United Nations (2011). Programme of Action for the Least Developed Countries for the Decade 2011–2020. No. A/CONF.219/3/Rev.1. United Nations publication. Sales No. A/CONF.219/3/Rev.1, Istanbul.

United Nations (2013). Resolution adopted by the General Assembly on 21 December 2012 A/RES/67/221. Smooth transition for countries graduating from the list of least developed countries.

WTO/EIF (2020). Trade impacts of LDC graduation: country-specific analyses. WTO/EIF, Geneva

Wade, R (2020). Growth, inequality and poverty. In: Global Political Economy. Oxford University Press, Oxford, UK.

Wade, R (2019). Catch-up and Constraints in the Twentieth and Twenty-fist Centuries, in (eds), Oqubay, A & Ohno, How Nations Learn: Technological Learning, Industrial Policy, and Catch-up. Oxford University Press, Oxford, UK.

Printed at United Nations, Geneva – 2111453 **(E)** – August 2021 – 231 – **UNCTAD/ALDC/2021/4**