Alonso,, José Antonio, Ana Luiza Cortez,, and Stephan Klasen. "LDC and Other Country Groupings: How Useful are Current Approaches to Classify Countries in a More Heterogeneous Developing World?." *Global Governance and Rules for the Post-2015 Era: Addressing Emerging Issues in the Global Environment*. By , edited by José Antonio AlonsoJosé Antonio Ocampo. London: Bloomsbury Academic, 2015. 347–388. *Bloomsbury Collections*. Web. 26 Apr. 2023. <<http://dx.doi.org/10.5040/9781472580740.ch-010>>.

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LDC and Other Country Groupings: How Useful are Current Approaches to Classify Countries in a More Heterogeneous Developing World?

José Antonio Alonso, Ana Luiza Cortez, and Stephan Klasen

1. Introduction

The developing world has become much more heterogeneous than in the past. There are still extreme international inequalities, but the economic situation of different countries is much more diverse than previously. In contrast to the North-South divide that underpinned development approaches in the past, there is now a wider and graduated spectrum of development between countries. It is therefore understandable that analysts, governments, and institutions aim to tackle that diversity by establishing categories for classifying countries to better analyze and organize the complexity of the international system. In fact, there has been a mushrooming of classification systems and country categories all striving to put some order in the new complex international reality but not fully succeeding. As a result, the international panorama has become more confused and disorganized, with several overlapping classifications.¹

The first official attempt to classify developing countries took place at the United Nations, which identified the least developed countries (LDCs) in the early 1970s. Several other proposals followed and were formulated in terms of diverse criteria, including:

- Per capita income level: high, middle, and low income, the criteria used by the World Bank since the 1980s; these categories are then an input to generate eligibility categories for the World Bank's main lending windows, IBRD and IDA (see below);

- Human development level: very high (VHHD), high (HHD), medium (MHD), and low human development (LHD), defined by the UNDP since the 1990s;
- Country indebtedness: Heavily Indebted Poor Countries (HIPC) as defined by the World Bank in the 1990s;
- Responsibility to address climate change issues: Annex I and non-Annex I countries, defined by the UN Framework Convention on Climate Change in 1992;
- State of governance: Fragile States (FS) which replaced the category Low-Income under Stress (LICUS) both generated by the World Bank and also adopted by the OECD-DAC in the early 2000s;
- Geographical features: Small Island Developing States (SIDS), and Landlocked Developing Countries (LLDCs) put forward by the United Nations; and,
- Access to and weight in international trade: Small and Vulnerable Economies (SVEs) defined by the WTO in 2002.

The net result of this proliferation of categories is that a single country can belong to various groups depending on the classification criteria adopted. For example, Burundi belongs to the following groups: the LDCs, LLDCs, FS, Low-income, Low Human Development, HIPC, and IDA-eligible; and Comoros belongs to LDCs, SIDS, Low-income, Low Human Development, IDA-eligible, and HIPC.

The complexity of the classification systems is underlined, on occasions, by the fact that institutions do not always coincide in their lists of countries that belong to a group. The most extreme case is that of the SIDS, a category for which there are as many as six different lists depending on which institution has produced it. Similar observation applies to the list of FS, where the criteria and country lists do not always coincide between the World Bank, the Development Association Committee of the Organization for Economic Cooperation and Development (OECD-DAC), and the United Kingdom Department for International Development (DFID), the three organizations that use this category the most (Harttgen and Klasen, 2012).

Diverse factors explain the accumulation of existing categories for countries. On the one hand, donors have approached country categories as a tool to allocate resources and support for development on the basis of supposedly technical criteria, even though the aid allocation processes are primarily political. On the other hand, the developing countries have

found in country categories a way to attract the attention of donors to their respective problems and to facilitate the process of lobbying that takes place in international forums and organizations. Lastly, the dynamics of the multilateral bureaucracies, and of their experts, has also supported this trend of generating new criteria to classify countries since those processes offer a means of justifying the relevance of their task organizing the complex and disorder international reality. In the end, categorization and classification are bureaucracy's important source of power (Vaubel, 1990). In fact, some international institutions seem to be involved in an intellectual competition to invent new acronyms to reclassify and rearrange groups of developing countries (van Bergeijk and van Marrewijk, 2013).

Not all the classifications referred to were created with a similar aim. Some of the categories were generated for merely analytical purposes or for pushing a particular view on development (human development groups, for example), while others were created with an international policy goal, linked to an administration with targeted means of support (that is the case, for instance, with the definition of the LDCs or the HIPC's). Experience has shown that, even classifications initially formulated for analytical purposes only, end up being used to set guidelines for international action (that is the case, for example, with the World Bank's income classification).

The proliferation of classification systems also indicates limitations of these systems in organizing the international landscape in a satisfactory manner. In fact, several—if not all of existing available systems—share, to some extent, three basic problems. First, they are based on fragile analytical and doctrinal foundation. In many of the cases, the relationship between the criteria shaping the classifications and the conclusions offered by the theory about the obstacles to development is rather vague or merely intuitive. Second, the very process of classifying countries assumes a political and normative choice (even if hidden in technicalities) about what is understood as development and about which problems or countries deserve special attention by the international community. The classifications, therefore, imply political choices; that explains why no one of them attracts unanimous acceptance. Lastly, some of the adopted criteria have been of very limited use in tracking the growing diversity of the international system in a coherent way. The tension between the need for the criteria to be stable and the rapidly changing reality of countries has led to very noticeable failures in the classification systems. In some of the categories, the level of diversity among countries belonging to a single group has progressively grown, reducing the relevance of the classifications themselves.

The LDC category is a case in point: the group currently includes not only 30 low-income countries, but also 14 lower-middle, two upper-middle, and one high-income country which, however, is earmarked to graduate in 2017. Similarly, as shown in Harttgen and Klasen (2012), the various attempts to define “fragile” countries have led to groupings where the heterogeneity within the fragile and nonfragile subgroups is much larger than the average difference between fragile and nonfragile states. In other cases, the problem is not so much diversity within a given group but the progressive loss of relevance of some of the categories. The income classification offered by the World Bank is a case in point: as a result of the growth of the world economy during the last decade as well as of the setting of absolute thresholds, the group of low-income countries now includes just thirty-four countries, barely 11 percent of the world’s population.

The above shortcomings suggest it is time for a careful diagnosis of the current situation. It is also necessary to ask whether there is a better way to manage and organize the increasingly complex international system. Several issues arise: should we persist in looking for a convincing classification system for countries or should we focus on identifying issues (more than countries) and then define ad hoc groups for particular issues when discussing international solutions to these issues? How could we improve the current categories to make them more useful? How could we make classifying developing countries less complex and more rigorous?

This chapter is concerned with answering these questions. We argue that great caution should be exercised when devising new country categories. In general, we have problems with developing additional categorizations that classify countries in a comprehensive fashion and are then used for aid allocation or general development rankings. Instead, we argue for issue-based classifications which often lead to more clearly targeted special support measures to tackle the issue in question. We also argue that the LDC category has a range of advantages as a comprehensive classification system but needs to solve the problems and incentives associated with graduation. This chapter is divided into seven sections in addition to this introduction. Section 2 provides evidence about the growing diversity that currently characterizes the developing world; Section 3 analyzes the main features of the LDC category; Section 4 discusses the foundations and limitations of selected classifications; Section 5 analyzes the problems linked to the use of comprehensive classifications; Section 6 discusses possible alternatives and, finally, some closing comments are made in Section 7.

2. Increasing heterogeneity in the developing world

Development theory was born in the 1950s, based on the conviction that developing countries confronted a socially specific reality that was relatively homogeneous and different to that of industrialized countries. International aid was built on the same assumption, implying the existence of a sharp North-South divide. That was quite a reasonable assumption then. As estimated by Maddison (2007), per capita income levels among European countries, the United States, Canada, Australia, and New Zealand were more than twice as high as the next richest group, Latin America, and about 8–10 times larger than in Asia and Africa. Now the reality is very different: the heterogeneity among developing countries has increased, with economies located along a more continuous scale of levels of development (Alonso, 2013).

Figure 10.1 illustrates the trend mentioned above. The level of heterogeneity among countries is measured by the coefficient of variation of the countries' per capita GDP (converted in PPP) for the period 1950–2008. The world's coefficient follows a visible increase after the 1980s and up to mid-2000s when it becomes stagnant. In the case of the developing world the coefficient of variation experiences a sustained increase from 1950, becoming particularly intense after the 1980s.²

Figure 10.2 offers another way to illustrate the same process. In this case four standardized density functions of the countries' GDP per capita (in PPP), are

Figure 10.1 Heterogeneity (coefficient of variation among GDP pc PPP)

Source: Maddison (www.ggdc.net/MADDISON/oriindex.html).

Figure 10.2 Standardized distribution of GDP pc (PPP)

Source: Maddison (www.ggdc.net/MADDISON/oriindex.html).

presented, with data from 1960, 1970, 1990, and 2008. The figure reveals that the level of concentration in the lower tail of the distribution (the left hand of the graph, corresponding to the bulk of developing countries) decreases over time; and, conversely, the level of dispersion in the upper tail (the richest countries) increases, particularly in the last density function (that of 2008).

As a consequence of this trend, the very term “developing world” has lost part of its accuracy as it now refers to very different national realities. In fact, some developing countries have a GDP per capita that is closer to that of developed countries than that of other developing countries. For example, Portugal (an OECD country) has a GDP per capita in PPP that is 1.35 times that of Argentina (a developing country belonging to the middle-income group); but Argentina has a GDP per capita that is fifteen times that of Zambia (another middle-income country) and forty-three times that of Burundi (a low-income country). On the whole, the ratio of per capita income between the richest and the poorest country is three to one in the case of industrialized countries, but that relationship is close to fifty to one in the case of the developing world (both in PPP).

The need to respond to this growing heterogeneity is a challenge for any system of classification of the developing world. Taxonomies will have to choose between two extremes: defining too many categories in order to preserve certain homogeneity among countries within the groups, or defining only a few categories and accepting high levels of heterogeneity among the countries within the groups. In the first case the taxonomy will be rather difficult to use (because

of the large number of groups) and in the second case it will be of limited use (because of the heterogeneity within the groups). The challenge is to find a well-defined option in-between.

3. The least developed countries (LDCs)

3.1. The category: Criteria and processes

3.1.1. *The origin*

The origin of LDC category dates back to the first session of the United Nations Conference on Trade and Development (UNCTAD I), held in Geneva in 1964. In 1969, the General Assembly acknowledged the need to alleviate the problems of underdevelopment of the less developed countries to enable them to draw full benefits from the Second UN Development Decade (IDS-II). In 1970, a separate section was devoted to the “least developed among the developing countries” within the framework of the IDS-II. Subsequently, the Assembly invited the relevant entities, including the Committee for Development Planning (the predecessor of the current Committee for Development Policy), to give high priority to the question of the identification of such countries and to report back on their findings.

In its reply to this request, the CDP indicated that there was a substantial gap between the poorest and the relatively more advanced developing countries. Apart from very low level of per capita income, which indicated severe financial constraints, the CDP identified other common features among the LDCs:

- Agriculture or primary activities dominate the generation of the GDP and in the absorption of the labor force; predominance of subsistence activities (limited capacity for mobilizing domestic resources) with low level of labor productivity, particularly in food production;
- Limited manufacturing and an undiversified production structure also reflected in the high export concentration and dependence on two or three primary commodities and high volatility of export earnings (upon which fiscal revenues rely);
- Low level of education and an overall shortage of skills to organize and manage development; limited capacity to absorb technological advances; poor health and nutrition outcomes;
- Lack of adequate physical and institutional infrastructure for development;

- Economically small (by population or national income), undiversified natural resource base (CDP, 1971).

Three indicators were selected as criteria to classify countries as LDCs:

- GDP per capita, which gives a general indication of the dimensions of poverty and overall level of development;
- The share of manufacturing in GDP, which conveys information on the extent of structural transformation of the economy; and,
- Adult literacy rate, which indicates the educational base for a skilled labor force.

Based on the criteria, adopted in a flexible manner, the Committee's list was approved by both the Economic and Social Council and the General Assembly in 1971.

The LDC category currently comprises forty-eight countries (see Table 10.1). The list grew over the years as countries gained independence and faced severe developmental challenges in some cases compounded by the devastating effects of independence war and conflict. A systematic review—the first of the triennial reviews—was conducted in 1991, the year when major refinements were introduced to the criteria (introduction of two composite indices on structural handicaps, the precursors of human assets index, HAI, and economic vulnerability index, EVI). The 1991 review also established graduation rules.

3.1.2. *The criteria*

Since it was first applied in 1971, the criteria to identify LDCs was refined and updated on several occasions to incorporate new development concerns, relevant advances in economic theory, and increased data availability. Yet, the criteria have always included the three components mentioned above: income, social progress, and economic vulnerability. Inclusion and graduation procedures have also evolved over the years.

The CDP defines LDCs as low-income countries suffering from severe structural handicaps to growth, whose identification is based on three criteria:

- (a) Per capita gross national income (GNIPc), converted by exchange rates in constant terms; and two composite indices of structural handicaps:
- (b) the human assets index (HAI), which gives an indication of the availability and quality of human capital; and
- (c) the economic vulnerability index (EVI) which measures economic structural vulnerability to exogenous shocks (Figure 10.3).³

Table 10.1 List of least developed countries as of March 2015

Country	Year of inclusion	Country	Year of inclusion
Afghanistan	1971	Madagascar	1991
Angola	1994	Malawi	1971
Bangladesh	1975	Mali	1971
Benin	1971	Mauritania	1986
Bhutan	1971	Mozambique	1988
Burkina Faso	1971	Myanmar	1987
Burundi	1971	Nepal	1971
Cambodia	1991	Niger	1971
Central African Republic	1975	Rwanda	1971
Chad	1971	Sao Tome and Principe	1982
Comoros	1977	Senegal	2000
Dem. Rep. of Congo	1991	Sierra Leone	1982
Djibouti	1982	Solomon Islands	1991
Equatorial Guinea ^a	1982	Somalia	1971
Eritrea	1994	South Sudan	2012
Ethiopia	1971	Sudan	1971
Gambia	1975	Timor-Leste	2003
Guinea	1971	Togo	1982
Guinea-Bissau	1981	Tuvalu ^b	1986
Haiti	1971	Uganda	1971
Kiribati	1986	United Rep. of Tanzania	1971
Lao PDR	1971	Vanuatu ^a	1985
Lesotho	1971	Yemen	1971
Liberia	1990	Zambia	1991
<i>Memo item: graduated countries</i>			
Botswana	1994	Samoa	2014
Cape Verde	2007		
Maldives	2011		

a/Scheduled to graduate in 2017

b/Recommended to graduate by the CDP in 2012. ECOSOC decision postponed to 2015.

Figure 10.3 HAI and EVI

Note: Numbers in parenthesis denote the weight of each indicator in the composite index.

Source: CDP Secretariat.

Every three years, the CDP undertakes a review of the list of LDCs, on the basis of which it advises the Economic and Social Council on countries that should be added to or those that could be graduated from the list. Threshold levels for each of the three criteria are defined, with the thresholds for graduation established at a higher level than those for inclusion. To be added to the category, a country must satisfy the inclusion threshold levels of all three criteria and have a population smaller than 75 million people. To be eligible for graduation, a country needs to fail two, rather than only one, criteria. Alternatively, a country may be eligible to graduation when its GNI per capita exceeds at least twice the graduation threshold on an anticipated sustained manner.

Additional information is used to support the CDP decisions besides the indicators in the criteria. In the case of inclusion, a *Country Assessment Note* is prepared by DESA. The Note pays particular attention to the reasons for the recent deterioration of economic and social conditions in the country in

order to determine whether that deterioration is due to structural or transitory factors. In the case of graduation, UNCTAD prepares a *Vulnerability Profile* (VP) of that country which provides an overall background of the country's economic and development situation. In addition, DESA prepares an *Ex-ante Impact Assessment* (IA) of the likely consequences of graduation for the country's economic growth and development, in particular on the expected implications of a loss of LDC status with regard to development financing, international trade, and technical assistance.

3.1.3. The intergovernmental process

The CDP holds consultations with countries on graduation and inclusion decisions. Inclusion requires approval from the country concerned, whereas graduation does not. Additionally, graduation requires that the country meets graduation thresholds in two consecutive triennial reviews. CDP recommendations on inclusion and graduation are forwarded to the Economic and Social Council for endorsement. Once endorsed, the General Assembly must take note of the recommendation before a country joins or leaves the category. Inclusion is immediate, while graduation takes place only three years after the GA acted on the recommendation. This provides the country with time to prepare a transition strategy, in cooperation with its development partners. The strategy—to be implemented after the country has officially graduated—aims at ensuring that the phasing out of support measures resulting from its change of status will not disrupt the country's continued development efforts as mandated by General Assembly resolutions 59/209 and 67/221. During this three-year period, the country is still an LDC and has access to all special measures available to the category (UNDESA/CDP, 2008).⁴

3.2. How useful has LDCs category been?

Currently, the major support measures extended to countries with LDC status vary among development partners and fall into three main areas: (a) international trade; (b) official development assistance, including development financing and technical cooperation; and (c) other forms of assistance (UNDESA/CDP, 2009).

Nonetheless, there is a significant problem with the way the support measures are designed and it is that they do not take into account the diversity within the group and therefore they are not adequately tailored to circumstances prevailing

at the country level. Part of this diversity has to do with the way inclusion and graduation decisions are made as discussed above. In fact, the current list of LDCs—not considering those already recommended or identified for graduation for the first time—includes seventeen countries that no longer meet the inclusion criteria, that is to say, they do not meet the inclusion thresholds in all three criteria. Accordingly, not all LDCs are low-income economies. LDCs share many common features and on average have poorer outcomes in terms of income, human capital structural vulnerability than the average of developing countries, but these outcomes may reflect different circumstances at the country level (CDP, 2010). Among the current forty-eight LDCs, eight are islands, while sixteen are land-locked economies. There is wide range in population size: from tiny Tuvalu to Bangladesh. Twenty-three LDCs were identified to be in conflict or postconflict situations in 2010 (Cortez and Kim, 2012). Economic structures also differ greatly across LDCs: six are fuel exporters, other six are manufacture exporters (largely textiles and garments), while ten are mineral exporters, eight are agricultural exporters and ten are service exporters (classified according to which export category accounts for at least 45% of exports of goods and services).

Overall, however, the category does not seem to have attracted special attention by bilateral donors, except perhaps initially in the 1970s. Momentum was not maintained in the 1980s and the 1990s when ODA flows to LDCs grew less (or contracted more) than flows to other developing countries. This trend reversed after 2000 but it is not clear whether the change is due to increased recognition of the category or due to the adoption of the MDGs with its emphasis on poorer countries and on social targets whose indicators are included in HAI. Few countries have consistently met the commitment of allocating 0.15 to 0.20 percent of their GNI to LDCs over the years. Several other factors are taken into account in allocative decisions by donors, including conflict and postconflict situation, development partnership history, governance performance, etc. In fact, the results of an econometric exercise indicate a significant correlation between ODA flows and low levels of income per capita and a low HAI, while the association is statistically insignificant in the case of EVI (CDP, 2011). The results of a UN DESA-CDP survey on seventeen donor countries confirm these overall findings (UN-DESA/CDP, March 2012, available from <http://www.un.org/ldcportal>). While the share of multilateral ODA going to LDCs is larger than the share allocated to LDCs by DAC donors (see Figure 10.4), multilateral flows to LDCs seemed to have followed similar trends: they contracted more than the flows going to other developing countries in the 1990s and recovered in the 2000s but not sufficiently to compensate for the previous decline.

Figure 10.4 ODA flows to LDCs, 1981-2011 (percentage share and current \$ million)

Source: OECD/DAC online database

4. Other classifications

4.1. The World Bank's country classification

The World Bank's income groupings are originally based on the Bank's operational lending categories, which are related to a country's eligibility for concessional financing. GNI per capita was considered to be the best indicator to offer a broad measure of a country's economic capacity. This was partly because other variables related to development achievements (such as infant mortality, literacy, or poverty) seemed to be highly correlated to GNI per capita. While this is case on average, there are many outliers as has been pointed out by Drèze and Sen (1989) and UNDP (1990), among many others.

The initial classification distinguished between developing countries, industrialized countries, and capital-surplus oil-exporting countries.⁵ In 1989 the current classification (low, lower-middle, upper-middle, and high income) was defined. The specific criteria used for determining the thresholds have never been published. Thereafter, the original thresholds have been updated to incorporate the effects of international inflation (measured by the average inflation of Japan, the United Kingdom, the United States, and the Euro zone).

For classifying countries, GNI per capita in US dollars is calculated with the World Bank's Atlas conversion factor. This factor takes into account in any year the average of the country's exchange rate for that year and those for the two preceding years, adjusted for the difference between the rate of inflation in the country and in a group of industrialized economies.⁶ This last rate of inflation is measured by the change in the Special Drawing Rights (SDR) deflator. By using three-year averages, the Atlas method is trying to reduce the bias introduced by short-term exchange rate fluctuations.

There are, however, two main shortcomings with the approach. First, as long as there has been a significant shift in the distribution of the world wealth, a wider spectrum of countries, including China and other emerging economies, should be taken into account in the determination of international inflation. Second, as is well known, market exchange rates underestimate purchasing power in low-income countries (due to the systematic undervaluation of nontraded goods and services in these countries). In fact, if we compare the variable used to define World Bank's categories with countries' levels of GDP per capita or GNI per capita, both in PPP terms, we could observe that an important group of countries move outside of their respective category and not in a linear way (Figures 10.5 a and 10.5b). While the PPP estimates of GNI

Figure 10.5a GNI per capita PPP and GNI per capita Atlas Method

Figure 10.5b GDP per capita PPP and GNI per capita Atlas Method

provide a more realistic picture of relative per capita incomes across the world, they are not without problems.⁷ Thus the choice to use the Atlas method by the World Bank has clear drawbacks and biases, but the alternative also has some drawbacks.

Based on GNI as the income concept and the Atlas method for exchange rates, all thresholds for the different income categories have been maintained constant in real terms over time. Therefore, the relationships between the thresholds are constant too.

This system has two related problems: (i) first, if the world economy evolves and continues to grow its income level, the thresholds risk losing their initial significance: for example, the high-income threshold could fall below the average world income level in the future; (ii) and second, if there is a continued trend of growth in the world economy, the number of countries belonging to the lower levels of income categories will fall further (and those belonging to higher levels of income will increase). That is what has happened in the last ten years. Although the number of reported countries has changed over time, the proportion of those belonging to the low income and lower-middle income categories has reduced significantly while the proportion of those belonging to the upper-middle and high-income categories has increased.

In the late 1990s, LICs (some sixty-three countries) represented 59 percent of the world's population, and close to 20 percent of the aggregated world GDP, when measured in PPP (see Table 10.2). However, over the period of 1999 to 2011, a great shift occurred within these groups. As a consequence, by 2010, LICs (only thirty-six countries) represented just 11 percent of the world population, and a minuscule 1.3 percent of world GDP (PPP). On the other hand, between 1998 and 2010, MICs (ninety-four countries in 1998 and 110 in 2011) increased

Table 10.2 The World Bank's income classification

	Number of countries				Population (in %)				GDP (PPP) (in %)			
	1990	2000	2010	2012	1990	2000	2010	2012	1990	2000	2010	2012
LICs	49	63	35	36	57,88	40,62	11,92	12,01	1,1	1,1	1,3	1,4
LMICs	56	54	56	48	11,91	33,80	35,99	35,58	8,8	9,0	11,3	11,6
UMICs	38	38	54	55	8,68	10,69	35,73	33,93	17,8	21,6	28,8	30,4
MICs	94	92	110	103	20,58	44,48	71,70	69,51	26,6	30,5	40,1	41,9
HICs	40	53	71	75	15,45	14,92	16,38	18,48	72,3	68,5	58,9	57,2
Total	183	208	216	214	100,00	100,00	100,00	100,00	100	100	100	100

Source: The World Bank.

their share of the world's population from 25 percent to 72 percent, and their contribution to world GDP (PPP) rose from 23 percent to 44 percent. Thus, the majority of the population of the developing countries no longer live in LICs (as in the past), but in the broader and more heterogeneous group of MICs. This is also the main reason why the majority of the world's income poor (using the \$1.25 a day classification) now live in MICs (Sumner, 2012).

In summary, while the World Bank's income classification has the advantage of simplicity there are a range of problems associated with the income indicator and the way groups are being formed.

4.2. Small Island Developing States (SIDS)

There is no UN officially recognized SIDS category. Nonetheless, the challenges of small islands have been on the international agenda for quite some time. Within the UN, the term SIDS starts to gain currency with the adoption of Agenda 21 at the UN conference on sustainable development in Rio de Janeiro in 1992 and its section on "sustainable development of small islands" (chapter 17, section G). In 1994, the United Nations adopted the Barbados Programme of Action for the Sustainable Development of SIDS (BPOA), which identified fifteen priority areas and the necessary actions to be taken at the national, regional, and international level. Progress on implementation of the BPOA was assessed by the UN in Mauritius in 2005 when the Mauritius Strategy for the Further Implementation of the Programme of Action for Sustainable Development of Small Island Developing States (MSI) was adopted.

The fundamental development challenges of SIDS, as described in literature, are related to size and location. The size issue relates to the smallness of SIDS regardless of the way size is defined. Population is the most commonly used measure of country size, although land area and volume of economic activity are also relevant indicators. The second major development constraint relates to location as many of these economies are remote from major international markets and/or located in zones subject to adverse weather phenomena.

However, development challenges emanating from these two features are also confronted by other developing countries (small domestic markets, reduced possibilities for economies of scale, limited natural endowments, vulnerability to adverse natural phenomena, remoteness, exposure to external economic shocks, import dependency, narrow export base, etc.) which makes identifying this group of countries on the base of their developmental challenges, or establishing a distinct category deserving special support measures, a complex issue

(Hein, 2011; Bruckner, 2013). Moreover, there is no agreement of how much small a country should be to be considered as a “small developing economy.” Membership in the group is largely by self-appointment. Thus far, there has not been sufficient political support across the UN membership, international donors, or developing countries for the creation of a criteria-defined category.

As a result, several unofficial lists of SIDS coexist. The lists by UN-DESA and Office of Higher Representative for LDCs, land-locked developing countries and SIDS (OHRLLS) are based on the membership of the Association of Small Island States (AOSIS). The AOSIS list includes entities where most of the land mass is not situated on an island (e.g., Belize, Guinea-Bissau, Guyana, Suriname) and had become members of the association due to being “low-lying coastal states.” It also includes several entities that are nonsovereign states (e.g., New Caledonia). The list of the UN Office of the Higher Representative for LDCs, LLDCs, and SIDS (UN-OHRLLS) is based on the list of the Alliance of Small Islands States (AOSIS) membership, but it differentiates UN member states from and nonmember states and adds Bahrain. UNCTAD’s list is more restricted, being limited to twenty-nine states, with populations not exceeding 5 million people, except for Papua New Guinea (see Table 10.3).

With self-selection underlying the composition of the group, heterogeneity prevails. A cluster analysis and principal component exercise indicated that while SIDS (DESA list but reduced to thirty-three countries due to data limitations) are more vulnerable to economic and natural shocks than other developing countries, there is a great deal of diversity. Even within the more homogenous subgroups of SIDS there seems to be need to have support measures designed to address specific development challenges (Bruckner, 2013).

4.3. Land-locked Developing Countries (LLDCs)

Land-locked developing countries constitute the third group of developing countries receiving special attention from the UN General Assembly and the UN system. Transport and transit issues of land-locked and transit countries were first addressed by the UN Conference on Transit Trade of Land-locked Countries in 1965, which was convened at the request of the General Assembly. In 1970, the General Assembly, within the context of the Second UN Development Decade (IDS-II), included a section on special measures in favor of LLDCs. In 1995, the GA endorsed the “Global framework for transit transport cooperation between land-locked and transit developing countries and the donor community.” In 2003, a UN global conference was convened in Almaty, Kazakhstan to review

Table 10.3 SIDS by UN-DESA, OHRLLS, and UNCTAD

American Samoa	Montserrat
Anguilla	<u>Nauru</u>
<u>Antigua and Barbuda</u>	Netherlands Antilles
Aruba	New Caledonia
<u>Bahamas</u>	Niue
<u>Barbados</u>	<u>Palau</u>
Belize	<u>Papua New Guinea</u>
British Virgin Islands	Puerto Rico
<u>Cape Verde</u>	<u>Saint Kitts and Nevis</u>
Commonwealth of the Northern Mariana Islands	<u>Saint Lucia</u>
<u>Comoros</u>	<u>Saint Vincent and the Grenadines</u>
Cook Islands	<u>Samoa</u>
Cuba	<u>Sao Tome and Principe</u>
<u>Dominica</u>	<u>Seychelles</u>
<u>Dominican Republic</u>	<u>Singapore</u>
<u>Fiji</u>	<u>Solomon Islands</u>
French Polynesia	<u>Suriname</u>
<u>Grenada</u>	<u>Timor-Leste</u>
Guam	<u>Tonga</u>
<u>Guinea-Bissau</u>	<u>Trinidad and Tobago</u>
<u>Guyana</u>	<u>Tuvalu</u>
<u>Haiti</u>	United States Virgin Islands
<u>Jamaica</u>	<u>Vanuatu</u>
<u>Kiribati</u>	
<u>Maldives</u>	
<u>Marshall Islands</u>	
<u>Mauritius</u>	
<u>Micronesia (Federated States of)</u>	

Note: DESA: used to monitor sustainable development trends (51 countries); UNCTAD: used for analytical purposes (29 countries); countries in italic font; OHRLLS: Member States that are SIDS (38 countries); countries in underlined font plus Bahrain.

the situation of transit transport systems, including the implementation of the Global Framework for Transit Transport Cooperation of 1995 and to formulate appropriate policy measures aimed at developing efficient transit transport systems in LLDCs. A Programme of Action is adopted as a result. It focuses on transport infrastructure development and maintenance, transit policies and trade facilitation measures.

Table 10.4 Land-locked developing countries

<i>Afghanistan</i>	<i>Malawi</i>
<i>Armenia</i>	<i>Mali</i>
<i>Azerbaijan</i>	<i>Moldova</i>
<i>Bhutan</i>	<i>Mongolia</i>
<i>Bolivia</i>	<i>Nepal</i>
<i>Botswana</i>	<i>Niger</i>
<i>Burkina Faso</i>	<i>Paraguay</i>
<i>Burundi</i>	<i>Rwanda</i>
<i>Central African Republic</i>	<i>Swaziland</i>
<i>Chad</i>	<i>Tajikistan</i>
<i>Ethiopia</i>	<i>Turkmenistan</i>
<i>Kazakhstan</i>	<i>Uganda</i>
<i>Kyrgyzstan</i>	<i>Zambia</i>
<i>Lao PDR</i>	<i>Zimbabwe</i>
<i>Lesotho</i>	

Note: Countries in italics are also LDCs.

The approach toward LLDCs seems to be similar to the approach on SIDS in the sense that there is a specific major framework umbrella governing the partnership relations among the various stakeholders as well as there is identification of problems to be tackled and the ways to go about them, but no group-specific support measure. Conversely, the identification of developing countries that are LLDCs is much less problematic than in the case of SIDS. There is a unique list of developing countries recognized as LLDCs (thirty-one countries, see Table 10.4), but these countries do not constitute a category with inclusion and graduation rules as it is the case of the LDCs.

4.4. Fragile states

In the late 1990s and early 2000s, a new category of “fragile” states was being created. Initially, fragile states largely referred to conflict and postconflict countries, following the pioneering work of Collier and his coauthors on the economic costs of conflicts (e.g., Collier and Hoeffler, 1998). To this, a group of countries was added, in which the state had basically ceased to function, or in which the writ of the state did not extend much beyond the capital city. Lastly, this discussion began to relate to an overlapping (but larger) group of countries, which the World Bank referred to as “low income countries

under stress” (LICUS).⁸ These countries have increasingly become a focus of some donors concerned about meeting the MDGs (Stewart and Brown, 2009; World Bank, 2011).

In recent years, a large body of literature has attempted to conceptualize and to define fragile states more precisely (e.g., Stewart and Brown, 2009; World Bank, 2006; ODI, 2006, 2010; DFID, 2005; USAID, 2005; Carment et al., 2006; OECD, 2008; Mata and Ziaja, 2009; CIPP, 2008; Rice and Patrick, 2008). However, a uniform approach is hindered by both a lack of data and a suitable framework to classify “fragile states.” In addition, many definitions do not consider the structural causes for fragility, nor do they differentiate between short-term shocks and long-term problems in individual fragile states. The selection of indicators to define fragile states is clearly crucial for the validity of the list of fragile states (Adcock and Collier, 2001). Existing lists differ by their theoretical background concepts but most concepts measure fragility along the four main dimensions: security, political, economic, and social dimension. These lists sometimes use objective criteria, sometimes value judgment seems to be involved, and, sometimes, a set of proxies is used to generate the list (see, also, Bourguignon et al., 2008).

Since 2006, the World Bank generated a list of fragile states using the Country Policy and Institutional Assessment (CPIA) rating of countries, thereby renaming countries previously referred to as low-income countries under stress (LICUS) (World Bank, 2006a, 2007a, 2009a) (Table 10.5). The CPIA rates countries against a set of sixteen institutional and policy criteria grouped into four clusters: (a) economic management (three indicators); (b) structural policies (three indicators); (c) policies for social inclusion and equity (five indicators); and (d) public sector management and institutions (five indicators). Countries that score less than 3.2 on the averaged indicator are defined by the World Bank as fragile states.

One of the main motivations of the fragile states category has been that these countries, as a group, need special and differential attention, particularly since they lag behind in achieving the MDGs (World Bank, 2010 and 2011).

But these statements about overall lower progress have to be treated with considerable caution. In particular, as shown in Harttgen and Klasen (2012), it is not the case that fragile states lag in MDG progress on average. Only if fragility is defined very narrowly and focuses on (relatively few) countries with multiple problems related to fragility, can one see somewhat slower progress.⁹ Also, they show that the heterogeneity in performance on MDG progress among fragile states is so large that it does not make a lot of sense to treat them as a group. This

Table 10.5 Lists of fragile states using different fragility definitions

CPIA 2008	OECD	DFID	CIFP	Stewart and Brown (failure)	Stewart and Brown (at risk)	Conflict-affected between 2003 and 2007	Fragile in all definitions listed here
Afghanistan	Afghanistan	Afghanistan	Afghanistan	Afghanistan	Benin	Afghanistan	Afghanistan
Angola	Angola	Angola	Angola	Algeria	Cambodia	Algeria	Angola
Burundi	Burundi	Azerbaijan	Bangladesh	Angola	Cameroon	Angola	Burundi
CAR	Cambodia	Burundi	Burkina Faso	Azerbaijan	Colombia	Burundi	CAR
Chad	Cameroon	Cambodia	Burundi	Bahrain	Congo, Rep.	CAR	Chad
Congo, Rep.	CAR	Cameroon	Cameroon	Belarus	Djibouti	Chad	Congo, D. Rep.
Congo, D. Rep.	Chad	CAR	CAR	Bhutan	Gabon	Colombia	Congo, Rep.
Comoros	Comoros	Chad	Chad	Burkina Faso	Gambia, The	Congo, D. Rep.	Eritrea
Djibouti	Congo, Dem. Rep.	Comoros	Congo, D. Rep.	Burundi	Guinea	Congo, Rep.	Guinea
Côte d'Ivoire	Congo, Rep.	Congo, Rep.	Congo, Rep.	Cameroon	Indonesia	Eritrea	Nigeria
Eritrea	Djibouti	Congo, D. Rep.	Eritrea	CAR	Kyrgyz Republic	Ethiopia	Sierra Leone
Guinea	Equatorial Guinea	Cote d'Ivoire	Ethiopia	Chad	Madagascar	Georgia	Sudan
Guinea Bissau	Eritrea	Djibouti	Georgia	China	Malawi	Haiti	Zimbabwe
Haiti	Gambia, The	Dominica	Guinea	Congo, D. Rep.	Mauritania	India	
Kiribati	Guinea	Eritrea	Haiti	Congo, Rep.	Mozambique	Iraq	
Sao Tome and P.	Guinea Bissau	Ethiopia	Iraq	Cuba	Pakistan	Israel	
Sierra Leone	Haiti	Gambia, The	Kenya	Eritrea	Papua New Guinea	Liberia	
Sudan	Iraq	Georgia	Lao PDR	Ethiopia	Senegal	Mali	
Solomon Island	Kenya	Guinea	Liberia	Gambia, The	Singapore	Myanmar	
	Kiribati	Guyana	Madagascar	Guinea	Solomon Islands	Nepal	

Timor Leste	Korea, Dem. Rep.	Haiti	Malawi	India	Sri Lanka	Niger
Togo	Lao PDR	Indonesia	Mali	Iraq	Sudan, The	Nigeria
Zimbabwe	Liberia	Kenya	Mauritania	Israel	Tajikistan	Pakistan
	Mauritania	Kiribati	Mozambique	Kenya	Tanzania	Peru
	Myanmar	Lao PDR	Myanmar	Korea, Rep.	Thailand	Philippines
	Nepal	Liberia	Nepal	Lao PDR	Togo	Rwanda
	Niger	Mali	Niger	Liberia	Tunisia	Senegal
	Nigeria	Nepal	Nigeria	Libya	Uganda	Somalia
	Pakistan	Niger	Pakistan	Mali	Zambia	Sri Lanka
	Papua New Guinea	Nigeria	Rwanda	Nepal	Sudan, The	Thailand
	Rwanda	Papua New Guinea	Sierra Leone	Niger		Uganda
	Sao Tome and P.	Sao Tome and P.	Somalia	Nigeria		
	Sierra Leone	Sierra Leone	Sudan, The	Oman		Uzbekistan
	Solomon Islands	Solomon Islands	Tanzania	Philippines		Yemen, Rep.
	Somalia	Somalia	Togo	Qatar		
	Sudan, The	Sudan, The	Uganda	Sierra Leone		
	Tajikistan	Tajikistan	Yemen, Rep.	Somalia		
	Togo	Timor Leste	Zimbabwe	Sudan, The		
	Tonga	Tonga		Swaziland		
	Uganda	Uzbekistan		Turkmenistan		
	Uzbekistan	Vanuatu		Uganda		
	Yemen, Rep.	Yemen, Rep.		Uzbekistan		
	Zimbabwe	Zimbabwe		Viet Nam		
				Zimbabwe		

Note: Countries in bold appear on all lists included in this table.

is, of course, related to the great heterogeneity of the conditions and factors that contributed to countries being included in the label “fragile.” In particular, some end up in the category due to past or present conflicts. But in some, where the conflict is largely over (such as in Cambodia), this is no longer such a handicap in terms of preventing MDG progress, while in others (such as D. R. Congo) conflict remains a serious problem and prevents progress on many fronts. Similarly, some countries have institutional weaknesses that are serious barriers to MDG progress while others suffer institutional problems that are less constraining.

In short, it is unclear whether a category called “fragile states” is really that useful for classifying countries. The conditions under which these countries operate are so diverse that tailor-made approaches and solutions are required.

4.5. UNDP’s human development classification

The UNDP’s classification is based on the Human Development Index (HDI), defined by the institution and published in the *Human Development Report* in 1990. The HDI is based on the human development approach, that focuses on the process of the enlargement of people’s capabilities and choices (Sen, 1998).

In spite of the difficulty to capture the full complexity of human capabilities in a single figure, the UNDP defined a composite indicator as empirical approach of countries’ level of human development and as a way to shift the attention of policy makers from economic-based objectives to more ample human well-being purposes. Therefore, three aspects—income, health, and education—were identified as the most important dimensions for approaching human capabilities, being combined in a synthetic measure. Originally, these three dimensions were measured through the following indicators: GDP per capita in PPP (income); life expectancy (health); and adult literacy rate and the combined primary, secondary, and tertiary gross enrolment rate (education).

Over the years, the index has been refined, including some changes to the indicators chosen to approach the different dimensions or to the procedures to calculate the aggregated index. In 2010, the UNDP embarked on another overhaul of the index. The reviewed composition of the HDI is now as follows: income is measured by GNI per capita with local currency estimates converted into US dollars using PPP; health is measured with life expectancy at birth; and education is measured by a combined measure of actual and expected years of schooling. Each component is transformed into a standardized scale since the values of the sub-indices are bounded between zero and one. Finally, the aggregate index (the HDI) is a geometric average of the three components.

Table 10.6 UNDP's human development classification

	Number of countries				Population (in %)				GDP PPP (in %)			
	1988	2000	2007	2012	1988	2000	2007	2012	1988*	2000	2007	2012
LHD	44	36	24	45	31.0	39.5	5.8	18.2	2.8	10.7	0.5	2.8
MHD	40	84	75	47	40.0	44.1	65.6	49.9	8.5	34.2	25.9	26.2
HHD	46	53	45	47	28.9	14.5	13.8	14.7	88.8	55.0	17.4	17.0
VHHD	–	–	38	47	–	–	14.8	16.1	–	–	56.1	54.0
Total	130	173	182	186	100	100	100	100	100	100	100	100

Source: UNDP.*In US \$.

The first Human Development Report divided the reported countries into three categories: low, medium, and high human development, in relation to the country value of its HDI. A new group was added in 2009: countries with very high human development. The UNDP did not explain the rationale of this classification, nor the thresholds that defined the different groupings.

In 2010, the UNDP changed its approach in defining categories: absolute thresholds were dropped in favor of relative ones. The distribution of countries' HDI was divided into four quartiles: developed countries are in the top quartile; the group of developing countries form the other three quartiles (low, medium, and high human development) (Table 10.6).

A relative classification system allows the thresholds to keep pace with the aggregate global level of human development. Therefore, this classification does not have the problem of the downward trend that characterizes those classifications that rest on absolute thresholds. On the other hand, it makes it harder for countries to “progress” from one category to the next. As to address this last problem, UNDP indeed went back to fixed cut-off points in its 2014 Human Development Report using the four categories used since 2009.

4.6. Highly Indebted Poor Countries (HIPC)

The HIPC Initiative was initiated by the International Monetary Fund and the World Bank in 1996, with the aim of offering highly indebted low-income countries special measures of debt relief and low interest loans to cancel or reduce external debt repayment obligations (largely to official multilateral and bilateral donors) to sustainable levels.

To receive debt relief under the HIPC, a country must first meet certain requirements that define the “decision point.” The main criterion was that

the country's debt remains at unsustainable levels despite full application of traditional, bilateral debt relief. Additionally, the country must be poor enough to qualify for loans from the World Bank's International Development Association or the IMF's Poverty Reduction and Growth Facility (PRGF). Finally, the country must establish a track record of reforms to help prevent future debt crises and must define a Poverty Reduction Strategy Paper (PRSP) through a broad participatory process.

After criticism, a comprehensive review of the HIPC Initiative was agreed in 1999 in order to provide faster and broader debt relief. The review affected, first, the thresholds to define debt sustainability. Debt was deemed unsustainable when the ratio of debt-to-exports exceeded 150 percent (previously was defined to 200–250%) or when the ratio of debt-to-government revenues exceeded 250 percent (previously 280%) *and* had an exports to GDP ratio of no more than 30 percent (from previous 40%) and a ratio of fiscal revenues to GDP no higher than 15 percent (from previous 20%).

In addition to the modified threshold requirements, the 1999 revision introduced other changes. First, the six-year structure was abandoned and replaced by a "floating completion point" that allows countries to progress toward completion in less than six years. Second, the revised HIPC allows for interim debt relief so that countries begin to see partial relief before reaching the completion point. Third, the PRGF heavily modified the previously existing Enhanced Structural Adjustment Facility (ESAF) by reducing the number and the complexity of IMF conditions and by encouraging greater input from the local community into the program's design. Finally, under the new practice of "topping up," countries that unexpectedly suffer economic setbacks due to external factors are eligible for increased debt forgiveness above the decision-point level.

In order to receive full reduction in debt, a country must establish a further track record of good performance in programs supported by the IMF and the World Bank, implement satisfactory key reforms agreed at decision point and implement its PRSP. Once a country has met these criteria, it can reach its completion point, which allows it to receive the full debt relief agreed at the decision point.

There are now thirty-nine countries classified as HIPC: thirty-five countries are at completion point and are receiving full debt relief; one country (Chad) has reached its decision point and has benefited from interim debt relief; and three countries are potentially eligible for HIPC Initiative but have not yet reached the decision point (Table 10.7).

Table 10.7 Heavily indebted poor countries (2014)

Completion point (thirty-five countries)	Between decision point and completion point (one country)	Pre-decision point (three countries)
Afghanistan	Chad	Eritrea
Benin		Somalia
Plurinational State of Bolivia		Sudan
Burkina Faso		
Burundi		
Cameroon		
Central African Republic		
Comoros		
Côte d'Ivoire		
Republic of Congo		
Democratic Republic of Congo		
Ethiopia		
The Gambia		
Ghana		
Guinea		
Guinea-Bissau		
Guyana		
Haiti		
Honduras		
Liberia		
Madagascar		
Malawi		
Mali		
Mauritania		
Mozambique		
Nicaragua		
Niger		
Rwanda		
São Tomé Príncipe		
Senegal		
Sierra Leone		
Tanzania		
Togo		
Uganda		
Zambia		

Source: World Bank.

In general terms, the HIPC Initiative has proved effective in handling the severe indebtedness of poor countries. It is also a positive example of a grouping of countries that is based on a particular issue with direct (and substantial) measures of support attached to it, rather than an all-purpose categorization to

group developing countries. As the debt issue has receded for most HIPC, the category is also fading away which seems to be a good approach for an issue-based grouping of countries.

5. Problems with comprehensive classifications

The proliferation of systems for classifying countries is not coherent and represents a problem for international coordination and governance of the development cooperation system. Instead of creating predictability, order, rationality, and transparency in terms of rules, principles, and approaches, this multiple classification results in the uneven treatment of individual countries and the existence of overlapping groups. Table 10.8 illustrates the extent of this overlap, indicating how many of the countries in each category also belong to other categories.

Overall, we could group the classification systems mentioned in the previous sections into two different types.

- i) The first type refers to those systems that classify countries according to wide development criteria: in these cases, a variable (or a set of variables) is sought to characterize the country's level of development. These classifications aim to be comprehensive and to classify all countries participating in the world economy. We could call these comprehensive or "country-based" classifications. Examples include the World Bank income classification system and the UNDP's human development index classification.

Table 10.8 Overlapping categories

	LDCs	SIDS*	LLDCs	LICs	LHDCs	FS**	IDA	HIPC
LDCs	48	8	17	30	37	24	44	29
SIDS		52	-	3	6	5	12	5
LLCs			29	15	15	8	18	11
LICs				36	30	26	32	26
LHDCs					45	33	42	33
FS						43	25	23
IDA							62	37
HIPCs								39

*SIDS by UN-DESA, ORGLLS, and UNCTAD.

**FS by OECD.

- ii) The second type relates those systems based on defining a relevant development challenge and identifying countries that suffer from it. This is a selective, rather than comprehensive, classification of the international system; and it tends to be based on particular issues identified rather than on a country's general features. We could call these selective or "issue-based" classifications. HIPCs, SIDS, LLDCs, and Fragile States are examples of this type. But as argued earlier, only the HIPC category has largely stuck to its direct issue-based mission.

The LDCs classification is somewhere between these two systems. On the one hand, it can be understood as a classification based on identifying a specific type of problem (extreme structural impediments to growth), and grouping together those countries suffering from that. However, on the other hand, the problems identified are so general and comprehensive that the system could be understood as follow-on from a generic distribution system of countries' developmental levels.¹⁰

5.1. Country groupings and aid allocation

As we highlighted at the start, some country classification systems are designed for purely analytical reasons, while others are associated with defining criteria for countries' eligibility for certain international aid measures. Frequently, though, even those classification systems that are not conceived to assign aid have ended up being used by some donors as part of their aid allocation process. This is particularly the case of the World Bank's income classification. There are hardly any bilateral donors that rely solely on the World Bank's thresholds for country eligibility or aid allocation. Instead they usually employ, in a discretionary and flexible way, additional criteria for that, including those related to donor's interest and strategic purposes. But most of them use countries' income per capita and even those crude income thresholds as major factors in that decision.

The same procedure is followed by an ample range of international financial institutions and global funds that use GNI per capita as a central factor in eligibility and graduation of countries' access to their measures of support (Table 10.9). More precisely, IDA defines for eligibility a maximum level of GNI per capita that is (\$1195) close to the threshold that the World Bank's classification uses for defining LICs. The same threshold is employed by the International Fund for Agricultural Development (IFAD), the African Development Fund, the

Table 10.9 Eligibility and graduation processes in some international institutions

Institution	Eligibility	Allocation	Graduation
IDA	GNI per capita (\$1195) Lack of credit worthiness	GNIpc Population CPIA	GNI pc Creditworthiness
IFAD	GNI per capita (\$1195) Lack of credit worthiness	GNIpc CPIA Rural population	GNI pc
African Development Fund	GNI per capita (\$1195) Lack of credit worthiness	GNIpc Population CPIA	GNI pc Creditworthiness
Asian Development Fund	GNI per capita (\$1195) Lack of credit worthiness	GNIpc Population CPIA	GNI pc Creditworthiness
Inter American Fund for Special Operations	GDP per capita (\$2587)	GDPpc Population CPIA	GDPpc
IMF Poverty Reduction and Growth Trust	GNI per capita (\$1195) Lack of credit worthiness	GNIpc Program-based conditionality	GNIpc Creditworthiness
GAVI Alliance	GNIpc (\$1510)	DTP3 Coverage GNIpc	GNIpc
Global Fund	World Bank income categories Disease burden Non-G20 Eligibility for ODA Population	Disease burden Indicative funding Performance	Transition to UMIC Member of the G20
European Commission	Income categories Country size	Income per capita (LICs and LDCs) Fragile states Other criteria	Size: more than 1% share of global gross domestic product (GDP) Income: Upper-middle-income countries, according to the OECD-DAC classification Other criteria (including HDI, economic growth, etc)

Source: Based on Salvado and Walz (2013).

Asian Development Fund, and the IMF's Poverty Reduction and Growth Trust. In accordance with the level of development of the region in which it operates (mainly composed by MICs), the Inter American Fund for Special Operation set the threshold in a higher level of GDP per capita (\$2587). Among the global funds, GAVI Alliance, the Global Fund and the Global Agriculture and Food Security Program (GAFSP) also use GNI per capita (and a similar threshold to the World Bank threshold) as criterion for countries' eligibility.

Although not being an exhaustive list, the cases mentioned are enough for confirming how a comprehensive category (the World Bank's classification) is used by an ample group of bilateral and multilateral donors as criterion for countries' eligibility and graduation for their measures of support. However, in this kind of classification, such a procedure can create problems related to equity, to incentives, and the necessary international coordination.

Problems of equity stem from the fact that systems for assessing eligibility and graduating countries link a reality that is continual and progressive internationally—the developmental level of countries—to a dichotomy: either a country is eligible or not eligible (*in or out*). That can lead to a situation where countries with very similar conditions receive notably different treatment because they are on either side of a threshold that in many cases is arbitrary. That can cause comparative grievances that are difficult to justify.

Second, there are problems of incentives that come from the way in which the criteria of graduation are defined. These have to do with general synthetic variables (per capita income level or human development level). In these cases, the removal of international aid seems to be associated with achievements in the level of countries' development. This is not the most ideal way to properly align the incentives of the international system. In some way, what the system is doing is penalizing success (and rewarding failure) by tying achievements to the removal of international aid.

Lastly, given the generic character of the classification criteria, there are many donors that share the same threshold for countries' graduation for aid, which could lead to resources being simultaneously withdrawn, without proper coordination, affecting the stability and progress of a country. Here we are not talking purely hypothetically. First, because there is strong interdependence of donor giving (Davies and Klasen, 2015); and, second, because there are many donors (particularly multilateral ones) who base their graduation criteria on the per capita income of the recipient country, defining the threshold for ending eligibility close to that which defines middle-income countries. As a result, Salgado and Lah (2013) estimate that, between 2013 and 2030, forty-one

countries will graduate from the IDA, fifteen will graduate from the African Development Fund, fifteen from the Asian Development Fund, and about thirty-eight from the GAVI Alliance. The simultaneous graduation from various organizations will mean some middle-income countries may lose between 25 and 40 percent of the international aid funds they receive. Such an abrupt withdrawal of funds, as well as severely limiting the total volume of resources available for the country, could affect the composition of spending since it will principally affect those elements—such as education and health—where aid financing is crucial (Salvado and Waltz, 2013). The costs of both processes may be significant.

In fact, where comprehensive classification systems are used, the processes by which countries graduate from receiving aid seems to be particularly inadequate. Nothing substantive has changed for a country when it overcomes an income (or HDI) threshold that is somewhat arbitrary (Alonso et al., 2014). In these cases, it would be better to substitute the current *graduation* procedure by a process of *gradualness*; in other words, it would be better to support national efforts, modulating aid intensity (and its content) to the abilities and needs of the recipient. Furthermore, support should be maintained until the risk of a country slipping backwards in terms of development are small, something that is impossible to ascertain by a simple variable such as GDP per capita or the HDI. Additionally, a well-designed transition period should be defined, to allow for a gradual (rather than abrupt) withdrawal of international aid, offering the country clear alternative cooperation mechanisms and supervision of its evolution, in order to ensure that withdrawing aid does not have serious costs to the processes of development. In the case of the LDCs, General Assembly resolutions 59/209 and 67/221 are positive steps in this direction.

5.2. The case of LDCs

The LDC category is a particular case among existing country groupings. It is sanctioned by the UN General Assembly which takes decisions on inclusion and graduation. It has a long history and a clear set of criteria, grounded on sound analytical foundations and the CDP (an independent body of experts) plays a substantial role in monitoring the process of countries' inclusion and graduation.

In contrast, most of the other groupings are either generated by a particular institution that is pushing a certain agenda with these categories, or by countries lobbying for a category. None of these categories have been officially approved

by any global body, in most cases not even by the governing bodies of the institutions that promoted them.

The CDP category also relies on a set of approved procedures for phasing out LDC-specific support. Yet, development and trading partners' compliance with these provisions has been uneven. In general, ODA flows have been maintained to LDCs that have graduated. This seems to be a logical outcome since as seen above donors do not necessarily allocate ODA according to LDC status. Yet, other types of support—of which the most relevant is arguably preferential market access—have been discontinued, sometimes abruptly by some partners,. It is worth noting however that in the specific case of market access, several LDCs participate in regional free trade agreements. Change of LDC status has no implications for market access in these cases. In any case, the potential loss of benefits creates a great deal of concern in graduating countries.

6. Alternative classification by issues

The problems that affect “country-based” classification systems do not affect “issue-based” classifications in the same way. At least, they do not if the aid measures are specifically designed to tackle the problems that define the category. Equity does not seem to be affected if aid measures designed to tackle a particular problem are not applied to a country without that problem (or one which no longer has the problem). It is nevertheless important to ensure that the problems identified are considered properly as shortcomings deserving of international support in order for the problem of equity not to arise. And the support should focus on the particular issue and not become an all-purpose category for special support, as the category of SIDS or fragile states might easily become. Nor do issue-based systems seem to suffer from the problem of simultaneous withdrawal of international support which appears in the graduation processes associated with the “country-based” system types. Given that support is associated with specific problems, the fact that a country overcomes one of the problems mentioned will not mean that it ceases to receive aid for the remaining problems it has that international aid tackles. Lastly, if issues and measures of support are properly defined, the problems of poor incentives associated with classification could also be avoided.

Notwithstanding the above, “issue-based” systems have two disadvantages worth considering. One refers to the possible fragmentation of the international system, as long as there are numerous development issues deserving of

preferential treatment by the international community. The other relates to the loss of a comprehensive approach to issues that are tightly interconnected.

In order to avoid the risk of a disorderly proliferation of categories and aid measures four basic criteria should be followed:

- First, given the proliferation of country classification, the creation of new categories should be subject to careful study. Some issues could give rise to support measures without necessarily defining a new group of countries subject to this treatment. For example, aid could be allocated in relation to the Economic Vulnerability Index (which is one of the indicators used for the LDC category), without creating any category for that. This approach has already been acknowledged by the General Assembly, in resolution 67/221, paragraph 23.
- Second, a category could be defined when the issue is important, deserves a specific set of support measures that is distinct from any other sets of measures applied to developing countries and requires certain international coordination (because implies a problem of collective action). It is important that the chosen issues do not raise problems of moral hazard (generating perverse incentives) nor link international support with policy options that should be freely decided by affected countries.
- Third, in order to evade the proliferation of groups, the issue-based classifications need to be designed from a relatively comprehensive view, taking into account the best way to order the complex and changeable reality of the developing world. Overall the issue-based classification systems appear to better address development issues pertinent to developing countries, as long as the issue is defined with objective criteria and monitored with sound data. The systems can avoid disorderly increases in the number of categories as long as the issues at hand are kept minimal.

On the other hand, in order to avoid a fragmented treatment of the interlinked aspects of development, it could be useful to maintain a comprehensive category for the process of aid allocation. But, in this case, the LDCs category is the best option for preserving the required comprehensive approach to basic development problems. It is the best founded category, based on a complex set of different development dimensions, and includes an ample list of the more needy countries in the world. Therefore, international donors should strengthen the role of LDCs in their measures of international support, avoiding the creation of new or alternative comprehensive categories that could compete or partly overlap with the LDCs category (such as the World

Bank's income-based category). This option is compatible when donors adopt an issue-based approach in order to identify sub-sets of more homogeneous countries that face similar challenges in the LDCs group or in the developing world as a whole, and design a set of specific measures of support to each cluster, complementary to those that are associated to the LDCs group.

A last point to consider is the legitimacy of particular categorizations. There is a strong case to be made that any country grouping—particularly those that are linked to countries' eligibility for measures of international support—ought to be transparent and carry legitimacy of the institutions who decide on inclusion and exclusion and its criteria. Here the LDC category has substantial advantages too.

7. Concluding remarks

We have considered various ways to group developing countries and assessed the merits and problems of each of these systems of classification. Clearly, the recent proliferation of categories has created a lot of confusion and fragmentation and many categories generate substantial problems. In this chapter we have argued that many of the country-based groupings and some of the uses of issue-based groupings are deeply problematic, create perverse incentives, and lead to problems of inequality in treatment. Additionally, often these groupings do not reflect homogeneity in the countries concerned and thus these groupings are simply not a valid way to sort countries. We would suggest two ways forward.

First, the creation of new comprehensive, country-based classification systems should be avoided. Donors can identify development issues that deserve international support, without defining any new category. In most cases, international donors could allocate aid and other measures of support based on sound and objective criteria linked to these identified issues. If new categories are needed at all, issue-based classifications are more useful and special support should be targeted to that issue. The HIPC category is a good example for such a grouping. Similarly, one could imagine that instead of generating an "all-purpose" SIDS category, it would be better to turn this proposal into a real issue-based categorization. For example, one could group countries that are severely threatened by rising sea levels, including not only pertinent small island states but also continental countries with a large land mass of low-lying areas. Such a category should then receive special support in particular programs of adaptation to climate change. Similarly, another group of small island states

(and some other remote countries) which are particularly remote from markets and trade routes could receive special support in “aid-for-trade” programs. Such issue-based groupings would be much easier to generate and maintain and would be more defensible for targeted support measures.

Second, for country-based systems, we believe that the LDC category has a range of advantages over other country-based groupings. They include a clear and transparent process and indicators, a track record and high legitimacy, and an independent body to monitor its implementation. In this regard, difficulties linked to graduation decisions in the intergovernmental process need to be addressed not to undermine the legitimacy of the category. At the same time, in view of the continuous or gradient nature of most development challenges, we also suggest that there should be no sharp distinctions made between those on the list, and those who are slightly better off or have recently graduated. Instead a more gradual approach to support measures is required to address some of the equity and incentive problems discussed above.

Notes

- 1 In this chapter, we focus particularly on classifications of the universe of developing and emerging economies. Of course, there has also been a multiplication of classifications and groupings at the rich end of the income spectrum, ranging from official groupings defined, for example, by membership in the OECD, to informal groupings such as the G8 or now the G20.
- 2 When using market exchange rates, the increase in heterogeneity of per capita incomes among developing countries over the past four decades would be even larger.
- 3 Detailed information on how the indices are calculated and respective data sources are available at the CDP website http://www.un.org/en/development/desa/policy/cdp/ldc_info.shtml and UNDESA/CDP, 2011. For a comprehensive historical background see Guillaumont (2009).
- 4 On smooth transition see also CDP Secretariat (2012). *Strengthening Smooth Transition for the Least Developed Countries. CDP Background Paper Series No. 14*, available from http://www.un.org/en/development/desa/policy/cdp/cdp_background_papers/bp2012_14.pdf.
- 5 The World Bank initially used membership of the OECD, with some unexplained exceptions, as the criterion to define the category of industrialized countries.
- 6 Initially, international inflation was defined by the average rate of inflation in the G-5 countries; after 2000, the average rate of inflation of the Euro Zone, Japan, and the United States was used.

- 7 Among the main problems, PPP factors of conversion are estimated based on complex and contested procedures. Second, they are only valid for particular benchmark years. Comparing per capita incomes across benchmark years can, however, lead to estimates that are inconsistent with the real growth rates measured in national currencies in the intervening period. Also, sometimes the estimates from benchmark years have led to massive revisions of PPP adjusted per capita income levels. For example, in the revisions made as a result of the 2005 benchmark year, China's and India's PPP adjusted GDP per capita was estimated to be 40 percent lower than previously believed. For a discussion, see Klasen (2013).
- 8 Apart from posing challenges for MDG progress, fragile states also pose challenges for development and aid policies as traditional models of engagement often do not work in fragile states. For example, the capacity to absorb aid is found to be lower in fragile states than in nonfragile states (McGillivray and Feeny, 2007), while the need for aid is, at the same time, considerably greater in fragile states than in nonfragile states. Consequently, in recent years, the international community has made a significant effort in attempting to develop strategies and instruments that effectively address the particular problems of fragile states (e.g., World Bank, 2006a, 2011; ODI, 2006; Dollar and Levin, 2005).
- 9 At the same time, it is true that fragile countries, regardless of the definition, perform worse in terms of levels of MDG achievement. So they are further away from the goals, but their rate of progress has not been slower.
- 10 In fact, the creation of the LDCs category seems to be linked to a desire by the international community to pay special attention "to the less developed among them [the developing countries]."

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