

APRIL 2014

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# COOPERATION WITH MIDDLE- INCOME COUNTRIES: AN INCENTIVE- BASED APPROACH

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José Antonio Alonso

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## Cooperation with middle-income countries: *An incentive-based approach*

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# PROLOGUE



The 2013-2016 Master Plan for Spanish Cooperation reflects Spain's commitment to the Middle-Income Countries (MICs). This can be observed in the statement that Spanish Cooperation should "promote debate in the international community about the need to maintain support to the MICs, and particularly about the best ways to work with them". This planning document draws attention to the increasing importance of this issue in the global development agenda, *inter alia* because of the increased number of countries that fall under this classification, on the basis of their per capita income.

In any case, this reiterates the clear strategic interest this matter has for Spanish development policy. However- and surprisingly- apart from the general references in master plans and in other documents, this priority lacks a firm doctrinal basis within the Spanish system. This means that, up to now, Spanish Cooperation has not defined specific strategic guidelines to justify this policy nor does it have general guidelines on how to put it into practice.

This is despite the fact that, since Spanish development cooperation began, it has placed middle-income countries in a prominent position as partners. Initially, this bias was not the result of a decision based on an objective analysis of factors; instead, it reflected the prevailing logic at the time: donors focused their help on countries that had been part of their former colonies and/or were located within their scope of geopolitical influence.

Thus, it was not surprising for Spain to focus much of its cooperation on this group of countries. Along this line, the first executive body for this policy, the Institute of Hispanic Culture, targeted actions toward Latin American countries, most of which were MICs. In the 1980s, when a new institutional framework was established for a more modern development cooperation, the privileged attention to these countries was evidenced through the opening of the first technical cooperation offices of what was then the Spanish Agency for International Cooperation – set up in 1987, 25 years ago- in Central America.

By the late 90s, and particularly since 2004, a process began which involved the extension of Spanish Cooperation's geographical scope, especially with the aim of increasing the support given to low-income countries in Sub-Saharan Africa. Even then,

this cooperation still favored MICs among their main geographical priorities.

Indeed, the IV Master Plan points out Spain's intention of focusing its aid on 23 countries at the end of its term, 16 of which belong to the MIC category. Likewise, Spain is one of the donor countries which have traditionally allocated most of its official development assistance (ODA) to these countries.

According to data from the OECD's Development Assistance Committee (DAC), in 2010-2011 the average Spanish net ODA that was channeled to middle-income-countries amounted to 55.7%. Although it fell significantly since the end of the previous decade, it was still well above the average for other DAC members (47.3%).

However, until the last decade not much attention was given to this distinctive aspect of Spain's cooperation when it came to defining a national policy in this area. Previously, the bias toward MICs did not appear to require an explanation. Nevertheless, with advances in the international development agenda, especially since the Millennium Declaration, which prioritized aid for poorer countries, this preference was quite noticeable for the donor community, giving rise to some criticism. So, at the beginning of the last decade, an attempt was made to justify the importance of maintaining support to middle-income countries. For this purpose, some studies were contracted and international seminars were held, but no significant impact was achieved.

By the mid 2000s, the political level of this effort was raised by partnering with the United Nations, which took great interest in the matter as it affects a large number of its member countries. This partnership was consolidated with the organization of the first Intergovernmental Conference on Cooperation with Middle-Income Countries in Madrid, on March 1 and 2, 2006. Additionally, Spanish Cooperation financed a book and several documents on this subject. However, shortly after it gradually lost the political impetus that had been achieved in the Madrid conference, and cooperation with middle-income countries fell into the background over the years that followed.

The topic was addressed again at a general level during the preparation of the IV Master Plan, due to the fact that the number of middle-income countries had increased considerably in recent years, and it was subsequently acknowledged that no development agenda makes sense if it does not consider this group of countries.

In this context, the Spanish Agency for International Development Cooperation/AECID (the main executing agency of Spanish Cooperation) decided to start a reflection of its own, especially aimed at facing the practical implications based on a review of its work with middle-income countries. A first step in this process was the commissioning of a study directed by Professor José Antonio Alonso, Professor of Applied Economics in the Complutense University of Madrid, and Researcher of the Complutense Institute of International Studies (ICEI).

The aim of this study was to provide a key reference on this subject, although it is not a Spanish Cooperation policy document. It was to be based on the consultation of actors within the Spanish system, particularly the Agency, while maintaining the rigor and objectivity of academic analysis.

In fact, this paper does not focus on the Spanish case, because it was also considered useful for disseminating these ideas to the entire international

community. It is important to avoid confining the debate on cooperation with MICs within our own system or our dialogue with these countries. Undoubtedly, it is an issue on which Spanish Cooperation can assume certain leadership beyond our borders, and so it may be used as a tool for advocacy within international fora.

For Spanish Cooperation, it is hoped that this document will be useful in stimulating reflections and analyses aimed at further improving practices.

Finally, it should be noted that this is a very appropriate topic to launch this series of Spanish Cooperation Working Papers: an instrument for the dissemination of analysis carried out by the organization's staff members, or studies commissioned to third parties. This initiative has modest pretensions, and in the same way as other cooperation agencies do, we hope to contribute relevant ideas for the development cooperation agenda, and to serve as a vehicle to systematize and broadly disseminate the knowledge produced by various actors within the Spanish aid system.

***Unit for Planning, Aid Effectiveness and Quality Unit, AECID***

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# EXECUTIVE SUMMARY



## 1.-INTRODUCTION

Acting upon the Paris Agenda recommendations, many donors reduced the number of countries in which they operate, partnering with countries with lower per capita incomes, or fragile States. Additionally, some donors proceeded to close their delegations in middle-income countries (MICs), or began to exclude such countries from their aid by applying graduation criteria based on per capita GDP. Consequently, the share of MICs in overall official development assistance (ODA) fell by one third in comparison with the 1990s.

Without questioning the preference for poorer countries, there are, nonetheless, good reasons to maintain an active policy of cooperation with middle-income countries. The majority of the total population and of poor people in the developing world reside in middle-income countries: ending poverty will be difficult unless we also work with the countries where most poor people live. Some MICs also suffer from considerable structural deficits and severe vulnerabilities which are a common source of bottlenecks and even reversals of their development process (the so-called “middle-income traps”): development cooperation can be an instrument to help those countries overcome said bottlenecks. Finally, middle-income countries are called to take on greater responsibility in the solving of regional and global problems: development cooperation may also play a role in supporting their growing involvement in global-scale cooperative actions. The above-stated reasons become even more relevant if we consider the major changes which are taking place in the international system, many of which are led by middle-income countries.

Greater donor involvement in these countries would have a two-fold consequence. Firstly, it would allow for cooperation to adapt more fully to the new global system, and respond to the fact that the majority of the developing world’s population (and poor people) reside in MICs. Secondly, it would lead to launching a more horizontal type of cooperation, based on incentives, integrated by multiple actors and using various instruments going beyond ODA, and which, up to a certain point, anticipates what future

development cooperation should be like, something which can be seen in the recent agreements of the IV High Level Forum of Aid Effectiveness of Busan.

In sum, the cooperation system should be willing to assume a more comprehensive and complex perspective, modulating its support and differentiating its agendas, resorting to combinations of different instruments from broader areas other than those of ODA, to suit the conditions and needs of recipient countries. The developing world is now more heterogeneous than before, and development cooperation system should be prepared to face such diversity.

## 2.- CHANGES IN THE INTERNATIONAL CONTEXT

Several changes in the international context have contributed to enhancing the role that middle-income countries are called to play in the global system in general –and in the cooperation system in particular– over the near future. Four key trends are underlined here:

First, the increasing heterogeneity of the developing world. International aid was born under the assumption that developing countries formed a homogeneous reality that was markedly different to that of developed countries (the North-South gap). Nowadays, reality is quite different: heterogeneity in the developing world is significantly higher, while countries are now situated along a broader (and continuous) spectrum of development levels.

One consequence of this process is the change in classification of countries based on their per capita income. The low income category is considerably reduced: in 2010 it included only 35 countries, representing 11% of the world’s population, while the heterogeneous middle-income group comprised 110 countries, or 72% of the world’s population. This means that most countries and the majority of the population of the developing world is now located in the middle-income category.

Responding to such heterogeneity is a challenge for the development cooperation system, faced with

two alternative options: one is to convert aid into a policy that is increasingly focused on fighting extreme poverty, with an agenda exclusively targeted on poorer countries; the other is to take a more integral perspective for all developing countries, working with differentiated agendas based on each country's specific conditions, including MICs with severe vulnerabilities. Of the two options, the latter is defended in this document.

Second, geographical patterns of poverty have changed. A first aspect to highlight is that there has been a significant reduction in the number of people living with less than 1.25 dollars a day (and the same applies to the 2-dollar threshold). Secondly, there has been a change in the location of poor populations: middle-income countries currently concentrate more than two thirds of the absolute poor population on a world scale. This geographical pattern is entirely new, since in 1990 over 90% of the absolute poor used to live in low-income countries.

Although middle-income countries have more chances to eradicate poverty than low-income ones, it is clear that not all of them can do so on their own and with the required speed and success levels. Development cooperation can contribute to this task, by boosting and supporting distributive and growth policies aimed at reducing poverty in partner countries.

Third, the emergence of an increasingly multi-polar world. Development assistance was launched within a world that was characterized by the presence of two opposing blocks; today, however, that world no longer exists, since a more complex and multi-polar world is taking shape. New developing world powers have emerged, characterized by highly dynamic economies and a growing capacity for international projection.

This multi-polarity requires a new view of the "common but differentiated responsibilities" principle: this can no longer be interpreted as a dualistic segregation between developed and developing countries, but rather as a continuum of levels of commitment based on each country's degree of development. This interpretation has major implications for the aid system, since many new powers, together with other MICs, have assumed those responsibilities by launching aid programs aimed at other developing countries, through various South-South cooperation actions, which donors should support.

Finally, the expansion of the space for international public goods, some of them being closely linked to the development agenda. In the current world, it is hard to reach any achievements in the fight against poverty unless action is taken within the sphere of international public goods (peace and safety, global health, climate change, financial stability, etc.); at the same time, progress toward the provision of these goods is hard to attain unless international inequalities are corrected simultaneously.

The appropriate integration of both agendas poses a major challenge for the international cooperation system, which must define the financial instruments and mechanisms for each case; and it must establish, when required, certain tradeoffs between respective priorities (for instance, between economic growth and environmental sustainability). In that regard, middle-income countries play a crucial role in the agenda of international public goods, not only because they are key for the provision of a large part of such goods, but also because as economies with increasing international presence, they are among those who are primarily concerned with the appropriate and fair definition of this agenda.

### **3.-WHY COOPERATE WITH MIDDLE-INCOME COUNTRIES**

The need to address the changes described before poses significant challenges to the development cooperation system. Restricting aid to fighting extreme poverty alone, focused on a small group of poor countries and ruled by traditional donors does not seem to be a good way of responding to the coming world. Instead, development policy should be conceived through a more comprehensive perspective, which comprises a large part of the heterogeneous developing world, with an agenda that is differentiated according to each country's conditions, which allows for shared but differentiated responsibilities by Southern donors, and attempts to connect the development agenda with the international public goods agenda. To sum up, aid should be conceived as an integral, complex and differentiated policy based on the conditions of each country, including those MICs which require it.

Nonetheless, in the case of middle-income countries, aid will always be a smaller part of their international funding. In this regard, if aid has an impact in those countries it will not be for what is directly financed by it, but rather because of the type of incentives it promotes in such countries. For this reason, aid must be especially considered for its capacity to:



i) mobilize additional resources and capacities; ii) alleviate restrictions and bottlenecks in change processes; iii) reduce uncertainties and risks; and, iv) promote change processes. This means that an incentive-based approach should be adopted.

**a) Eradication of Poverty**

The high concentration of poverty in middle-income countries may suggest that donors' attention should be placed on those countries. However, aid should be conceived as a mechanism geared towards boosting and supplementing the capacity of countries to address their own problems. From this perspective, what is truly relevant is not the actual number of poor people in a given country, but rather that country's capacity to address its own poverty. Based on this viewpoint, available data confirms that poorer countries are those which are in most need of aid.

In fact, within a broad group of MICs, there is the chance that these countries address poverty eradication action by themselves. In such cases, aid should not be offered to replace such responsibility. Even so, aid could play a role (a smaller one) by supporting social and distribution policies aimed at fighting poverty, promoting their design through technical assistance and the exchange of experiences.

Within the middle-income group there are also countries that have limited fiscal space for redistributive action, which makes it really difficult for them to assume the goal of eradicating poverty by themselves and in the short term. In those cases, international aid may be a necessary complement.

**b) The Middle-Income Traps**

Persistency of poverty is just one of the many problems middle-income countries face. These countries also have structural deficiencies and imbalances which often threaten the sustainability of their development paths: these are the so-called "middle-income traps". Such problems particularly affect those countries' governance conditions within a context of high inequality and social fragmentation, difficulties in their international financial integration preserving, at the same time, their macroeconomic stability; these are shortcomings in making required changes in their energy patterns without affecting their convergence process, or, reducing their ability to maintain a continuous path of productive and technological change and improvement in the living standards.

International development cooperation can help countries avoid these traps. The impact of

development cooperation will probably not be the same in all cases.. For example, it may have a significant effect on the lack of social cohesion or the low quality of institutions. It can also have a role in promoting technological innovation and productive change, as well as in encouraging transformation in the energy model. Finally, it may have a minor relevance for a third group of issues, such as increasing the room for counter-cyclical macroeconomic policies.

**c) Promoting International Cooperative Action**

The reasons that justify cooperation with MICs are associated not only with the need to overcome internal problems this type of countries face, but also with the support to their efforts to become more actively involved in dealing with common problems on a global scale. It is about assuming a new conception of the "common but differentiated responsibilities" principle, giving more active participation to those Southern countries with higher levels of development particularly upper (middle-income countries) within a more committed collective action on a global scale. One of the tasks of development cooperation should be to create the conditions and provide incentives so that this involvement is effective in contributing to fairer global governance.

**4.- AID ALLOCATION AND COUNTRY GRADUATION**

In some cases, the withdrawal of aid from middle-income countries is motivated by the existence of country eligibility and graduation systems which are based on per capita GDP. However, this is a very inadequate criterion for aid allocation: on the one hand, because it fails to consider all the relevant aspects required for diagnosing a country; on the other hand, because it is based on an average which often does not adequately reflect the diversity of situations that can be found within a single country. This is particularly relevant in the case of MICs, which are characterized by a remarkable internal heterogeneity in their productive, social and regional spheres.

Besides, the very logic of graduation is controversial, as it creates problems both in terms of equity and incentives within aid policies. It affects equity because it subjects a reality that is continuous by nature –this is, the development level of countries– to a dichotomous logic: eligible versus non-eligible. And, with regards to incentives, it is problematic



because withdrawing aid from countries making progress does not help promote their national development efforts. Beyond these aspects, the fact that several donors apply the same graduation criterion (for example, recipient's upgrade to the middle-income category), may lead to a simultaneous and uncoordinated withdrawal of resources, thereby affecting a country's conditions for stability and progress.

Therefore, if we want to establish eligibility and graduation criteria, these should be built through a process: first, they should be based on a broad range of indicators, so that they offer a rich and comprehensive view of a country's situation; second, these criteria should not incorporate perverse incentives to the system; and, third, they should be accompanied by alternative cooperation mechanisms for candidates to graduation, in establishing a set of follow-up criteria for their transition period, in order to ensure that aid withdrawal does not entail serious costs for the affected country.

This is important in connection with the EU's new development policy, which is laid down in the document, *Increasing the impact of EU Development Policy: An Agenda for Change (2011)*. This policy adopts the differentiation criterion, including a graduation process for access to grants for a large number of countries. The arguments used to support these decisions are based on the search for a greater degree of selectivity in international action, identification of the added value offered by Community cooperation and complementarity with the development policies of member states. It is difficult to refute the relevance of such goals: however, the proposal is liable to attract some criticism, for three reasons at least: i) it gives too much weight to per capita GDP as a factor to determine a country's eligibility and graduation; ii) in order to define priorities, it resorts to country categories which are highly heterogeneous; and iii) there is insufficient clarity as to the alternative support mechanisms that would assist graduated countries, and it includes no design of a transition and subsequent follow-up phase for the graduated country.

## **5.- AGENDA FOR COOPERATION WITH MIDDLE-INCOME COUNTRIES**

Cooperation with MICs should be used to meet two major goals: to help countries overcome the obstacles that hinder their development (tackle the middle-income traps), and to support their efforts to assume

a more central role in international cooperative action.

### **a) Overcoming Middle-Income Traps**

Although MICs face various problems, most of them can be classified into three large areas: governance, economic stability and productive transformation.

The first trap refers to the country's governance conditions. As countries make progress, they require increasingly complex institutions, capable of dealing with coordination issues inherent to the more developed economies, and able to meet the needs of more demanding societies. Both processes do not always occur at the same pace, and frequently, advances in economic and social areas are not accompanied by a parallel renovation of the institutional framework, thus creating a problem that may affect the sustainability of the development process.

In many cases, the problem lies not only in the weakness and limited efficiency of institutions, but also in their reduced credibility, which is fueled by the extraordinary levels of inequality and the social/regional fragmentation that is typical of some middle-income countries.

In this context, strengthening the institutional framework and improving social cohesion should be one of the key work areas for international cooperation. The aim should be not only to improve institutional efficiency, but also their ability to articulate collective action, which necessarily leads to factors connected with institutional credibility and legitimacy.

The second problem area is the effect of countries' increasing integration into the international financial markets under the conditions of macroeconomic stability required for sustainable growth. In this case, the mobilization of national resources, the encouragement of savings, broader opportunities to design counter-cyclical macroeconomic policies and the correction of existing asymmetries in the international financial markets are crucial.

Development cooperation plays a limited role in solving these issues. Most of them remain the responsibility of national governments, leaving international cooperation to fulfill the function of providing technical assistance and exchanging experiences, if required. Some donors have a greater capacity for action in the sphere of international financial regulation, influencing international

economic governance bodies (such as the G-20). A third group of problems is associated with the difficulty MICs have in maintaining a process of productive and technological change to sustain their development path. As per capita income levels rise, salary costs increase and economies must move toward more dynamic specializations, which involves applying greater technological capabilities and more qualified human resources. Environmental imperatives have set new constraints to these processes, calling for changes in existing energy and production models. Countries do not always have the required capacities to promote such changes, and so they are caught in one specialization that does not allow them to make their productivity grow at the right pace, thus preventing the sustainability of their convergence process.

Within this sphere, the role of development cooperation is limited, but not irrelevant. This is especially true if we consider development cooperation beyond what is strictly reportable as ODA. There are six fields in which cooperation can be deployed: i) supporting innovative enterprises; ii) supporting the promotion of technological capacities and knowledge transfer; iii) promoting sustainable energy models; iv) improving infrastructures; v) supporting the training of skilled manpower; and vi) defining a regulatory framework to enhance technological and business dynamism.

### **b) Promoting Cooperative Action at a Global Scale**

The second purpose of cooperation with middle-income countries is to support and strengthen the role of these countries at an international level, so they can take on increasing responsibility and decision-making power in overall governance. This goal can be seen in four main areas.

First, in support to South-South cooperation. The existence of this modality challenges the strictly dual vision of cooperation (donors versus recipients) that was predominant in the past, making it clear that tackling inequalities is now a shared task to which all countries are called to contribute, based on their respective capacities.

It would be reasonable for traditional donors to back up the efforts of MICs to create an efficient and technically solid South-South cooperation system, by supporting the institutions in charge of such policies. Through triangular cooperation, traditional donors can become involved in more active support to South-South cooperation, amplifying the available resources. Likewise, donors may support cooperation

initiatives at a regional scale, by promoting cooperative action and mutual learning mechanisms at this level. Finally, the increased presence of non-DAC donors in the cooperation system should entail a review of the system's governance structures, opting for those which are more inclusive and representative.

Second, middle-income countries have a leading role in regional integration schemes. This role results from the size and, in some cases, from the dynamism of said countries, which create major externalities within their regional environment. Some donors have found in such effects a reason to maintain their cooperation with certain MICs (sometimes referred to as "anchor countries").

Cooperation should support these initiatives, particularly in three areas. First, by enhancing the human and technical capabilities of the institutions in charge of integration processes; second, by promoting experiences of inter-governmental policy coordination within the region, so as to build a culture of trust and joint work between partners; last, by supporting initiatives geared towards improving inter-country connectivity, particularly those linked with improvements in their physical and communication infrastructure.

Third, MICs have, given their weight and dynamism, a relevant role in the provision of regional and global public goods; they are also among the most affected countries when their provision is insufficient. The international community should establish some support mechanisms for middle-income countries to offset part of the costs they incur in the provision of international public goods, encouraging them to adopt a more committed role in the management of common problems. This task is particularly critical in the case of regional public goods, whose provision depends on the actions of the countries in question.

One last sphere in which development cooperation policy should be applied is in connected with the effect of other policies –other than aid- on the prospects for progress. For many MICs, the importance of aid is relatively low; and, conversely, as they are highly integrated in the international market, these countries are highly affected by donors' policies. This explains why one of the essential aspects of cooperation policy with these countries is to improve the levels of coherence in terms of policies. Thus, in an increasingly global world, policy coherence is not a goal that can be confined to the domestic sphere: it should also affect the totality of the regulatory frameworks for international relations.

## 6- INSTRUMENTS AND ACTORS

Given the kinds of problems which MICs face, cooperation policy design should have some specific traits. In this regard, three general guidelines seem relevant: i) first, action should be highly selective and strategic, identifying the core issues in each country which obstruct the path towards progress, and those in which cooperation may be effective; ii) second, given the internal heterogeneity of countries, we should consider the need to adopt sub-national perspectives when it comes to designing actions; and iii) finally, due to its limited weight, the role of aid will consist in modifying the incentive framework within which agents operate, while additional instruments other than ODA may prove crucial in these countries.

As a result, the planning of interventions in middle-income must be highly context-specific. It requires a prior rigorous effort involving diagnosis and dialogue with the recipient country, a strategic ability to define actions in a very selective way, specialized technical capacity to address the specific requirements on which to focus interventions, and a broad vision to identify the most appropriate actors and instruments (sometimes beyond those predominantly reported as ODA).

In terms of modalities, the advantages of program-based aid, on the grounds of its greater predictability, may be useful for MICs, although in these cases instruments which are either highly intensive in financial resources (e.g.: budgetary support), or are highly intrusive in the recipient's decision-making process (e.g.: sector-wide support) will be less relevant.

For middle-income countries, technical cooperation, associated to institutional strengthening, deployment of recipient's technical capacities and policy design is very important. However, technical cooperation should overcome some of its typical limitations, putting more emphasis on the development of local capacities instead of being a mere transplant of donor's capacities; this implies cooperation aimed at strengthening institutional capacities, less dependent on expatriate technical staff and more sensitive toward knowledge applicability under local conditions.

Due to the type of actions proposed, it is essential for middle-income countries to rely on cooperation instruments operating beyond ODA, many of

which are linked to the presence of new actors –like the private sector- within the cooperation system. Work in the areas of enterprise promotion, investment on infrastructure, support to innovation and technological capacities or business financing requires instruments which are only partly reportable as ODA. The new financial mechanisms are a part of this new arsenal of instruments. Cooperation managers should pay special attention to the possibilities offered by these new mechanisms.

As in other cases, cooperation with MICs involves multiple actors. Still, there are three specific aspects that must be stressed. First, in view of the social fragmentation of many countries, it is important to work with an organized civil society, supporting its tasks of advocacy and demand to public authorities, in order to promote change. Additionally, NGOs may play a key role for the access to services by the most marginal sectors, thus supplementing public policies.

Second, considering various cooperation fields of activity, it is important to involve specialized actors with very specific technical competences, many of whom are not frequently engaged in development cooperation. Knowledge and trust-based relationships to involve these actors in development interventions may not always exist, and so it requires additional efforts on the part of public sector managers.

Finally, in view of the greater proximity between donor and recipient, and the diversity of the actors involved, it is essential to deploy a more horizontal, networked activity, by adding up the capabilities and expertise of the various actors. In these cases, official agencies should give up their former role as service providers, in order to become mediators, to identify problems, talk to those involved, create the necessary conditions to lay down a network of cooperative response, and define incentives (including financial incentives) to ensure the efficiency of such coordinated action.

To sum up, all of this suggests that it is vital to maintain support to MICs that face difficulties, but the contents and implementation methods of this support should be very different than those traditionally applied in the cooperation with poorer countries.

# 1. INTRODUCTION: DEVELOPMENT COOPERATION IN A CHANGING WORLD

Although with some delay, the current economic crisis has ended up having a negative impact on the flows of international aid. According to DAC data, official development assistance (ODA) flows dropped by 2.7% in 2011 and by 4% in 2012. This fall is not limited to a small number of countries in difficulty; instead, it is a highly generalized trend among donors. In fact, 8 out of the 23 bilateral donors cut their aid in 2010, going up to 16 in 2011, and 14 in 2012. This trend is a result of the severity of the crisis and the magnitude of the fall in tax revenues seen in a large number of donor countries, who have not only reduced their available resources, but have also decreased the weight of aid within among governmental priorities (and those of public opinion). Under these circumstances, it is reasonable to worry about the future of aid, and the interest in the appropriate allocation of available resources in order to increase their effectiveness, while new financial mechanisms and new partners in development promotion are sought. It is necessary to re-think the cooperation system, to adapt it to an environment characterized by financial restrictions, which will probably be prolonged: the reflections in this document should be framed within this context, although the proposal which is put forward differs from those suggested by some donors.

The crisis has interrupted a remarkable period of growth and reform of aid, which took place, with some interruptions, during the 2000s. In fact, it was at the end of that decade when aid reached its maximum peak in actual terms, channeling 128 billion dollars (up from barely 79 billion in 2000). As resources increased, an active agenda was initiated in order to review the procedures applied by donors, so as to improve the levels of aid effectiveness and quality. The 2005 Paris Declaration, the 2008 Accra Agenda for Action and the Global Partnership for Development Cooperation Effectiveness of Busan in 2011 are the major milestones of that process. The basis of these agreements is the search for a two-fold

objective: to reduce aid transaction costs (through greater donor specialization and coordination), and to impose a certain balance in the relationship between donor and partner countries (insisting on the ownership of development processes).

However, the level of success in reaching these goals has been limited, as evidenced by the external assessments of the Paris Agenda (OECD, 2011); still, the efforts made to reform the aid system cannot be denied. The problem is that the international context changed more quickly and intensively than the cooperation system itself. The increasing heterogeneity of the developing world, the changes in the global geography of poverty, the emergence of new international powers from the South, the expansion of space for international public goods, the deterioration of environmental conditions and the presence of new actors in the cooperation system pose significant challenges which shall determine the future of the development cooperation system.

Changes in the doctrinal framework were accompanied by a modification of the geographical distribution of aid. Encouraged by the recommendations of the Paris Agenda, many donors reduced the number of countries in which they operate, selecting as preferential partners those with a lower income, or considered fragile states (a category not recognized by the UN). As a result, low-income countries (LICs), especially those in Sub-Saharan Africa, have become the main aid recipients over the last decade, while middle-income countries (MICs) significantly reduced their relative presence in overall ODA. The process was significant enough so as to exclude MICs from the aid expansion process of the previous decade.

This can be seen more clearly in the decision by some donors in recent years to leave these countries and close any delegations they had there. This has mainly affected Latin American countries,

a region composed almost entirely by MICs. The European Union itself adopted this form of action through its communication, *Increasing the impact of EU Development Policy: An Agenda for Change*<sup>1</sup>, in which it defines a graduation system for upper middle-income countries (and some lower middle-income countries) in terms of access to grants, which entails a considerable reduction in concessional funds available for this type of countries. Additionally, graduation systems based on per capita GDP in many international institutions and programs will intensify the impact of resource withdrawal on MICs.

Change in aid allocation may seem to be in line with the dynamism which emerging market MICs have acquired in the international sphere. Indeed, it is actually within that broad and heterogeneous group where the most dynamic poles of the last decade's global economy can be found; and this prominent role is expected to continue in the near future. It appears as if the success reached by some of these dynamic economies has rendered aid almost dispensable for the stratum to which they belong.

Nevertheless, it would be a mistake to think that such successful behavior can be generalized to the entire group of MICs; or that the economic circumstances of the last decade, which lead to faster growth, will be sustainable in the near future. A considerable number of MICs suffer from severe structural deficiencies which threaten their development processes; and some of those countries have experienced bottlenecks in their progress dynamics as a consequence of serious problems experienced in their internal transformation processes and in their forms of international integration. It is within these environments where the so-called middle-income traps emerge, which, even though they differ from those found in poorer countries, equally block their respective development processes. In these cases, development cooperation can make a difference, by helping those countries overcome their structural weaknesses and consolidate their development achievements.

For this reason, we must assume that development policy should adopt a broad and comprehensive approach, going beyond the mere fight against extreme poverty. Such an approach, without questioning the basic principle of distributive progressiveness that characterizes aid (giving more to those who have less), also reserves some support for the most vulnerable MICs. In these countries,

cooperation should be more selective, attempting to define incentives for change, combining instruments apart from ODA. In sum, the cooperation system should be willing to take on different agendas, resort to various instrument combinations, and to operate with scopes broader than ODA, adapting itself to the conditions and needs of recipient countries. The developing world is now more heterogeneous than in the past, and the development cooperation system should be prepared to deal with such diversity.

Maintaining support to MICs is more relevant if we consider that the number of countries which belong to the low-income stratum is increasingly low, and the number of poor people residing in middle-income countries is higher. According to the World Bank's classification (2013), only 36 countries belong to the low-income group, while 103 countries (85% of the developing world's population) belong to the middle-income category. Furthermore, said group of countries contains two thirds of the global population living with less than 1.25 dollars a day (a similar conclusion is obtained in the case of 2 dollars as the poverty line). These data suggest, first of all, that eradicating extreme poverty today is more feasible than it was ever before, as the number of people living in extreme poverty has decreased, and more resources are available to the countries in which these people live; but, secondly, that such a goal could be hard to reach if they are left unattended and international support is withdrawn from MICs with high poverty levels and severe vulnerabilities.

In any event, this contribution is necessary if we seek to enhance the provision of international public goods. Some of them are crucial to obtain development achievements and to preserve safety and progress conditions in the international stage (think, for example, of climate change). MICs are called to play a prominent role in this field, from a two-fold perspective: on the one hand, as key contributors to the provision of this type of goods, and as major affected parties in the event of their under-provision, on the other. This double implication emphasizes the dual role which these countries should play in the international system, both as countries deserving support, but also as active contributors to the solution of global problems.

This dual role in the development cooperation sphere is confirmed through the increasing boom of South-South cooperation. More and more MICs are becoming involved in active cooperation programs with other developing countries. Apart from the

<sup>1</sup> *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions. Brussels, 2011. [http://ec.europa.eu/europeaid/what/development-policies/documents/agenda\\_for\\_change\\_es.pdf](http://ec.europa.eu/europeaid/what/development-policies/documents/agenda_for_change_es.pdf) (last review: 29/09/2013)*



additional resources entailed, what is most relevant about this cooperation modality is the sense of involvement and shared responsibility in certain development activities promoted between countries which are not typical OECD donors. At the same time, it encourages healthy competition within the cooperation system, by providing styles, ways of doing and priorities that do not always match those of traditional donors.

Finally, in addition to the presence of new official donors, there has been an expansion in the number of actors operating in the development cooperation system, especially as a result of the involvement of those coming from the private sector (companies and foundations), who sometimes operate through instruments which are not strictly reportable as ODA. This also involves incorporating new cultures and ways of working in the system, which are influencing traditional approaches to aid. This increasing richness and complexity of cooperation policies is particularly relevant for MICs, where non-traditional aid system actors should operate, and where ODA, in its traditional sense, will become less important, to the benefit of other potential cooperation instruments.

In sum, over the last two decades there have been major changes both in the international sphere and in the international aid system. MICs are in the limelight of many of these changes. For this reason, it is important for donors to reassess their position with regard to this group of countries: greater donor involvement in these countries would have a two-

fold impact. Firstly, it would allow for cooperation to respond more fully to the new configuration of the international system, and deal with the fact that most of the developing (and poor) population lives in MICs. Secondly, it would allow for cooperation that is more horizontal, incentive-based, comprising multiple actors and resorting to various instruments, beyond those offered by the ODA. To a certain extent this anticipates what development cooperation of the future should look like, that which seems to be taking shape in the recent agreements by the IV High Level Forum of Aid Effectiveness of Busan. Therefore, the question here is to re-think the cooperation system we want for the future, taking into account the change trends observed in the international system. Which are those trends? What reasons justify cooperation with MICs? What is the most suitable agenda for this type of countries? How should we implement cooperation and what is the role of different actors? These are some of the questions for which this document intends to provide answers.

This document is divided into six sections, in addition to this introduction. Section two analyzes the change trends in the international system; section three presents the reasons to justify cooperation with MICs; section four deals with the appropriateness of basing aid allocation on country classification and graduation criteria, with a specific reference made to the EU; section five discusses the agenda for MICs; section six includes some observations concerning the implementation of cooperation and the role of actors in this type of countries; finally, section seven outlines some brief conclusions.

## 2. CHANGES IN THE INTERNATIONAL SYSTEM



As noted earlier, although the cooperation system has evolved, the world has changed much more. Many of those transformations have helped emphasize the role that MICs (the “world’s middle class”, so to speak) are called to play in the international –and cooperation–system over the immediate future. Therefore, it is worth reviewing those trends, four of which are listed below.

### 2.1. INCREASING HETEROGENEITY IN THE DEVELOPING WORLD

Development theory was born in the 1950s, based on the assumption that developing countries made up a relatively homogeneous reality, different to that of developed countries. International aid was founded on a similar idea, which also implied assuming the existence of a large gap between the North and the South (the North-South divide). Nowadays, reality is quite different: heterogeneity in the developing world has increased significantly, while countries are occupying a broader (and continuous) scale of development levels.

The increase in the developing world’s heterogeneity can be observed in the dispersion parameters and in the very shape of the standardized distribution function of per capita income (Alonso, 2012 and 2013, Alonso and Ocampo, 2012). As a consequence, the very term developing countries is less meaningful than before, as it refers to a set of quite differentiated national realities. In fact, the distance between some developing countries and high-income countries is smaller than the gap existing with other countries within their same group. By way of example, the per capita income of Portugal (OECD high-income country) in purchasing power parity terms is 1.35 times greater than Argentina’s (MIC); but the latter has a per capita income that is 15 times greater than

**TABLE 1. CHANGES IN WORLD BANK CLASSIFICATION OF COUNTRIES**

	NUMBER OF COUNTRIES				POPULATION (%)				GNI PPP (%)				RATIO OF GNI PER CAPITA IN PPP BETWEEN RICHEST AND POOREST COUNTRY IN EACH GROUPING			
	1990	2000	2010	2012	1990	2000	2010	2012	1990	2000	2010	2012	1990	2000	2010	2012
Low Income	49	63	35	36	57,88	40,62	11,92	12,01	1,1	1,1	1,3	1,4	6,52	8,07	7,03	6,38
Lower Middle-Income	56	54	56	48	11,91	33,80	35,99	35,58	8,8	9,0	11,3	11,6	5,22	3,52	5,23	4,51
Upper Middle Income	38	38	54	55	8,68	10,69	35,73	33,93	17,8	21,6	28,8	30,4	2,90	3,83	3,50	3,77
Middle-Income	94	92	110	103	20,58	44,48	71,70	69,51	26,6	30,5	40,1	41,9	14,79	7,61	14,01	12,78
High income	40	53	71	75	15,45	14,92	16,38	18,48	72,3	68,5	58,9	57,2	2,15	2,03	3,36	4,30
<b>TOTAL</b>	<b>183</b>	<b>208</b>	<b>216</b>	<b>214</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>95,93</b>	<b>74,48</b>	<b>205,97</b>	<b>180,97</b>

*Source: prepared by author based on World Bank data*



**TABLE 2: AID ALLOCATION BY INCOME LEVEL (%)**

	1990-93	1998-2000	2006-08	2009-2010
LLDC	31,8	32	35,1	46,6
LIC	10,2	12,5	17,2	16
LMIC	49,4	47,1	39,7	28,9
UMIC	8,6	8,5	7,9	8,5

Source: DAC (OECD), DAC Statistical Tables

Zambia's (even though this is also a MIC) and 43 times greater than Burundi's (LICs). Additionally, the ratio between the most and the least developed countries in the high-income category is barely 3 to 1; but that same ratio is 35 to 1 in the case of the developing world.

One consequence of this process can be seen in the country classification method used by the World Bank<sup>2</sup>. The low-income category has significantly decreased, in such a way that it included only 35 countries in 2010, representing 11% of the world's population (1.3% of aggregate GDP in purchasing power parity terms), while the heterogeneous middle-income group included 110 countries, making up 72% of global population (44% of aggregate GDP) (Table 1). In the last correction, in 2013, the number of LICs was 36, and MICs amounted to 103. This means that the bulk of countries and population of the developing world are located in the middle-income group.

The need to deal with such heterogeneity constitutes a challenge for the development cooperation system. In principle, two alternative options are possible: either to turn aid into a policy that is increasingly focused on fighting extreme poverty, with an agenda specializing in this goal and aimed exclusively at poorer countries; or, alternatively, to maintain an integral perspective for all developing countries, working with differentiated agendas based on the circumstances of each affected country, including those MICs with severe vulnerabilities. Many donors appear to favor the first option, but –as noted further on– there are good reasons to opt for the second one.

## 2.2. THE NEW DISTRIBUTION PATTERNS OF POVERTY

The MDGs encouraged changes in the patterns of aid allocation: donors tried to target their resources in a more focalized manner towards poorer countries,

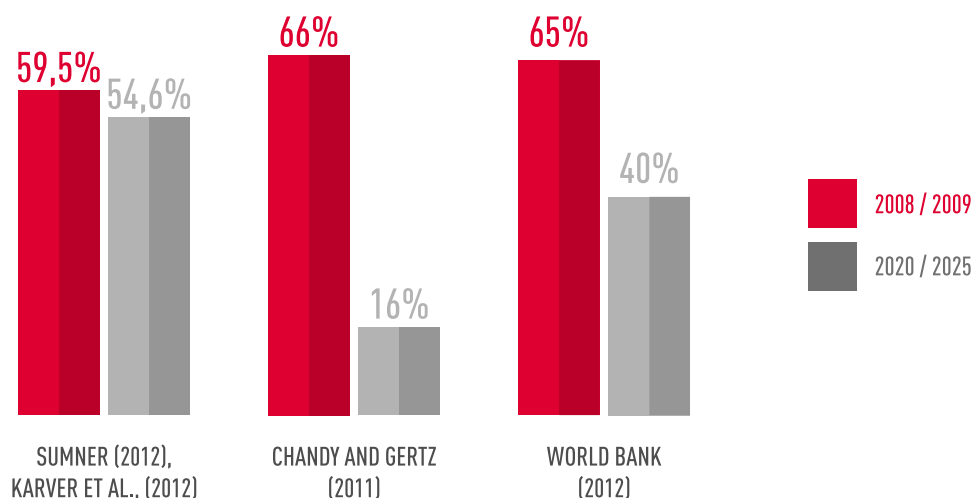
**TABLE 3: DISTRIBUTION OF GLOBAL POVERTY (1.25 DOLLARS/DAY)**

	NOT ADJUSTED BY BASE YEAR				ADJUSTED BY BASE YEAR			
	1990		2007		1990		2007	
	Millions	%	Millions	%	Millions	%	Millions	%
LIC	1,596.1	94.5%	305.3	24.1%	1,632.5	93.1%	342.7	29.1%
MIC	93.2	5.5%	960.4	75.9%	121.4	6.9%	836.0	70.9%
<b>Total</b>	<b>1,689.3</b>	<b>100%</b>	<b>1,265.7</b>	<b>100%</b>	<b>1,753.9</b>	<b>100%</b>	<b>1,187.7</b>	<b>100%</b>
China and India	1,137.9	67.4	673.0	53.2	1,123.6	64.1	561.3	47.6
MICs without China and India	-	-	287.4	22.7	-	-	274.6	23.3
LIC without China and India	458.2	27.1	-	-	509.0	29.0	-	-

Source: Sumner (2012)

<sup>2</sup> The World Bank sorts countries into three income strata. The most recent classification (2013) sets down the following thresholds: low-income (per capita GNI lower than \$1,035), middle-income (per capita GNI between \$1,036 and \$12,615), and high-income (per capita GNI over \$12,616). In turn, given the heterogeneity of the middle-income stratum, the latter was divided in two: lower middle-income (per capita GNI between \$1,036 and \$4,085) and higher middle-income (per capita GNI between \$4,086 and \$12,615).

**FIGURE 1: PERCENTAGE OF GLOBAL POVERTY IN MIDDLE-INCOME COUNTRIES**



significantly reducing the share formerly held by MICs (in particular, those of lower middle-income) (Table 2). This new resource allocation seems to be in line with the redistributive nature of aid, but does not correlate with the new location patterns of poverty on a global scale.

In fact, if one observes the evolution of poverty over the last two decades, two facts stand out. First, there has been a significant reduction in the number of people living with less than 1.25 dollars a day. Although there are some discrepancies in terms of figures, all estimates coincide in this trend (Chen and Ravallion, 2012; Chandy and Gertz, 2011). Indeed, for 2015 (target year for achieving the MDGs), forecasts estimate that the number of absolute poor will be 600-1,000 million (this is, 10% to 16% of the world's population)<sup>3</sup>. Bearing in mind that in 1990 (baseline year for the MDGs), poverty affected 43% of the world's population, we can understand the significance of the progress made up to now. And, most importantly, everything seems to indicate that the trend towards the reduction of absolute poverty will be maintained over the fifteen years (Kharas and Rogerson, 2012).

It is interesting to observe that, while the volume of absolute poverty has decreased, this is not the case with relative poverty, which is highly conditioned by distributive patterns within each country. The weight of national factors in determining this indicator causes its measurement to lack comparability on a global scale (a relatively poor person in Sweden may be a wealthy individual in Burundi). To tackle this problem, while also considering country

heterogeneity, the concept of weakly relative poverty was defined, which considers an absolute minimum sum that is required to live, but also contemplates poverty thresholds adapted to the circumstances of each country (Chen and Ravallion, 2012, Ravallion and Chen, 2011)<sup>4</sup>. So, the number of people affected by weakly relative poverty has barely changed over time (2.4 billion in 1990 and 2.7 in 2008), while the share of this group in the overall world population has declined (from 65% to 47%). Therefore, we are heading toward a world with less absolute poor, but where relative poverty is persistently high.

The second relevant fact is the new location of poor people in relation to country income levels. More precisely, using World Bank data for 2008, Sumner (2010, 2012) confirms that two thirds of the world's absolute poor (around 1 billion people) live in MICs, while the remaining third (approx. 300 million) are located in LICs (Table 3). This geographical pattern is entirely new, since in 1990, 94% of absolute poor lived in low-income countries. This assessment is not modified much if instead of measuring poverty through the available economic resources, we refer to other parameters connected with peoples' living standards. Thus, for example, nearly 70% of the global burden of disease (measured through the disability-adjusted-life-year, DALY) concentrates in MICs, with 21% in LICs and 8% in high-income countries (HICs) (Glassman et al, 2011, Salvado and Waltz, 2013).

This change in poverty location was influenced decisively by the graduation into middle-income status of several developing countries with very

<sup>3</sup> The most optimistic estimation corresponds to Chandy and Gertz (2011), with 600 million, while the one by Chen and Ravallion (2012) amounts to 1000 million.

<sup>4</sup> To make the difference clear: an increase in average income, without altering the country's internal distribution, would leave relative poverty unmodified, but would reduce the "weakly" relative poverty.

**TABLE 4: NEW REGIONAL POWERS**

REGIONS AND COUNTRIES	NUMBER OF COUNTRIES	PERCENTAGE OF REGION'S POPULATION (%)	PERCENTAGE OF REGION'S GNI (PPP)	SHARE OF REGIONAL GROWTH
<b>LATIN AMERICA AND CARIBBEAN</b>				
BRAZIL		33	32,3	33
MEXICO		19.2	23.5	14.7
<b>TOTAL</b>	<b>33</b>	<b>52.3</b>	<b>55.8</b>	<b>47.7</b>
<b>NORTH AFRICA</b>				
EGYPT				
<b>TOTAL</b>	<b>5</b>	<b>40.9</b>	<b>42.6</b>	<b>44.9</b>
<b>WESTERN AFRICA</b>				
NIGERIA		45.8	53.8	60.2
<b>TOTAL</b>	<b>23</b>	<b>45.8</b>	<b>53.8</b>	<b>60.2</b>
<b>EASTERN AFRICA</b>				
	11			
<b>SOUTHERN AFRICA</b>				
SOUTH AFRICA		30.3	66.9	55.9
<b>TOTAL</b>	<b>14</b>	<b>30.3</b>	<b>66.9</b>	<b>55.9</b>
<b>WESTERN ASIA</b>				
IRAN		35.6	32.2	32.9
<b>TOTAL</b>	<b>13</b>	<b>35.6</b>	<b>32.2</b>	<b>32.9</b>
<b>SOUTH ASIA</b>				
INDIA		74.9	82.5	85.4
<b>TOTAL</b>	<b>8</b>	<b>74.9</b>	<b>82.5</b>	<b>85.4</b>
<b>EAST ASIA</b>				
CHINA		62.7	55.7	77.5
INDONESIA		10.7	5.2	4.9
<b>TOTAL</b>	<b>17</b>	<b>73.4</b>	<b>61.1</b>	<b>82.4</b>
<b>CENTRAL EUROPE</b>				
RUSSIA		40.4	52.9	50.8
TURKEY		20.9	24.9	22
<b>TOTAL</b>	<b>33</b>	<b>52.3</b>	<b>55.8</b>	<b>47.7</b>

*Source: World Bank.*

high numbers of poor people (particularly China, Indonesia, India, Nigeria and Pakistan). The important question is whether the new pattern will remain stable over time. Projections do not fully coincide in this regard, but those based on reasonable criteria suggest that, over the next decade, 40%-60% of the world's poor population will continue to live in MICs<sup>5</sup> (Figure 1).

Therefore, the accumulation of poverty is not an exclusive problem of LICs: MICs also suffer from it. And, although these countries have greater capacities than the first group to address the challenge of eradicating this scourge, it is not clear whether all of them can do it on their own and if they can do it fast and effectively enough. Development cooperation can contribute to this task, by stimulating and supporting these countries' efforts.

However, it should be noted that poverty in MICs is frequently not usually the result of generalized deficiencies but rather it is due to the inequality of distribution patterns within a country. In these cases, the role of cooperation should not be focused on funding the poor's needs but rather on supporting the redistributive and inclusive focus of domestic public policies. Reducing poverty will therefore be addressed mostly by national policies which are less dependent on the direct provision of resources from abroad and more focused on combining the promotion of growth with the correction of internal inequalities.

### 2.3. A MULTI-POLAR WORLD

Development assistance began in a bipolar world, characterized by the existence of two opposing blocks; today, however, that world no longer exists, and in its place, a more complex and multi-polar world is shaping up. New powers from the developing world have emerged; they are highly dynamic and have a growing capacity for international projection (Spence, 2011).

Data confirm this idea. Developing countries and emerging markets already represent around 52% of global GDP in terms of purchasing power parity, with China, India, Indonesia, Brazil and Russia contributing 32% of overall GDP (such shares would be 34% and 18%, respectively, if GDP was measured at current exchange rates). Additionally,

that group of countries already represents 42% of the global trade flows, in which the exchange between developing countries is increasingly prominent. Finally, reaffirming their prominent role, a growing part of international capital flows go to these countries which hold three quarters of the global official reserves, and own many of the most active sovereign capital funds.

This change can also be observed upon identifying the poles of growth in the global economy. The estimation of polarity indices (World Bank, 2011) confirms that industrial economies, which promoted world growth over the last decades, have been replaced by a group of key economies –virtually all of them MICs– which have emerged as future centers of dynamism in the international economy. Among them, China occupies a key position, but the group is expanded to include at least India, Brazil, Indonesia, Korea, Turkey and Russia (although not all of them have a similar dynamism). These economies as a group will provide around 45% of aggregate GDP in terms of purchasing power parity by 2030 (such share would be 32% at current exchange rate) (Subramanian 2011).

This process has another relevant consequence: some large-sized MICs have become major growth poles in their regions. In virtually all regions of the world (maybe with the exception of Eastern Africa), one or two countries are accountable for three quarters of aggregate regional growth (Table 4). In these cases, the progress of such countries is key to ensure the sustained dynamism of their regional environment. Some donors have selected these countries as priority partners, using the “anchor country” concept to define the role they play within their regional context (BMZ, 2011).

This growing multi-polarity of the international system creates the opportunity to build more inclusive and democratic governance structures at a global scale; to a large extent, because the challenges of a multi-polar world require more cooperative solutions. However, international evidence reveals that this result is neither easy nor spontaneous. The behavior of some of these new powers sometimes seems more in line with a reproduction of the bipolar world of the past than with a sincere adhesion to a more democratic and inclusive governance. In any case, the above-described multi-polarity entails a new (and broader) view of “common

<sup>5</sup>The most optimistic estimation was made by Kharas and Rogerson (2012) who place this share somewhere below 20%; Sumner and Mullet (2013) increase this share up to 62% and the World Bank (2012) estimates that the proportion could be somewhere around 40%.

but differentiated responsibilities”: a principle that may no longer be interpreted on the basis of a clear division of responsibilities between developed and developing countries, but rather as a continuum of commitment levels, according to the differentiated development levels of each country. This interpretation has major implications for the aid system, because many of the new powers, together with other MICs, have launched aid programs aimed at other developing countries through diverse forms of South-South cooperation. This is a way of applying this new view of the “common but differentiated responsibilities” principle, by actively involving the most developed Southern countries in global governance tasks and in the correction of international inequalities.

#### 2.4. INTERNATIONAL PUBLIC GOODS<sup>6</sup>

Globalization has intensified interdependencies and externalities between countries, beyond national borders. As a result, certain issues that were previously exclusive for a given country have now become shared issues, which require a cooperative effort at a global scale to be solved; at the same time, other problems have arisen with a global nature from their very origin. It is within this field of interdependencies and strong externalities that the space inherent to international public goods (IPGs) emerges. Although very diverse in nature, these goods affect crucial aspects of collective life, such as the regulatory framework for international relations (treaties, institutions and rights), the actions required to reduce collective risks (health, peace and the environment, for example) and the conditions to encourage progress (knowledge dissemination, financial stability or commercial integration, for example).

Due to their strong externalities, international public goods, once provided, are available for everybody without restrictions (the same could be said, but with an inverse effect, of public “bads”). Consequently, the market by itself is incapable of ensuring their efficient provision, and there is a need to resort to various forms of collective action. In the international sphere, as there is no coercive State, this action takes the form of voluntary coordination and cooperation between countries. The multilateral system is the most appropriate framework to promote and articulate this response. However, there is a widely held opinion which claims that the

multilateral system, in its current form, fails to meet the right conditions to perform this task effectively. Therefore, in order to improve the provision of such goods, a reform of the rules and structures of the international governance is required.

There is a close relationship between the agendas of international public goods and the development agenda (Kaul et al., 1999 and 2003, Sandler 2004, Alonso 2002). The discovery of vaccines (such as that for malaria), the struggle against climate change, or the preservation of financial stability (all of these being international public goods) can have a greater development impact than many international aid programs. This does not mean that the traditional development agenda should be subsumed to the public goods agenda: they are two different, yet complementary, agendas. They are different both in their theoretical basis and in their distributive implications, but both agendas are connected. Achievements in the fight against poverty are hard to attain unless action is taken within the realm of international public goods (peace and safety, global health, climate change, financial stability, etc.); at the same time, making progress in the provision of these goods is difficult unless international inequalities are corrected simultaneously (UNIDO, 2008).

The appropriate integration of both agendas poses a major challenge for the international cooperation system, which must define the financial instruments and mechanisms required for each case; and, when required, it must set any necessary tradeoffs between respective priorities (for example, between economic growth and environmental sustainability). MICs play a crucial role in this public goods’ agenda, not only because they are key agents for the provision of a large portion of IPGs, but also because as their economies are expanding constantly, they are among those most interested in the proper design and application of this agenda.

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As we have seen, the international system is undergoing major change trends; these trends are expected to remain –or intensify– over time, and are reconfiguring the international scene. All of them tend to underline the fundamental role which MICs are called to play in the development system. Table 5 offers a summarized image of these implications.

<sup>6</sup>International public goods are those goods whose powerful externalities exceed national frontiers. This category comprises cross-border, regional and global public goods, depending on the scope of their effects.

**TABLE 5: GLOBAL CHANGE TRENDS:  
 IMPACT ON MIDDLE-INCOME COUNTRIES**

<b>CHANGES IN THE INTERNATIONAL CONTEXT</b>	<b>GENERAL CONSEQUENCES</b>	<b>IMPLICATIONS FOR COOPERATION WITH MIDDLE-INCOME COUNTRIES</b>
Increasing heterogeneity of the developing world	Developing countries have very differentiated capacities and needs	b) Differentiate agendas and instruments based on each country's conditions.
New poverty distribution patterns	The war on poverty is a common task for all affected countries	a) Support (not abandon) MICs in their fight against poverty  b) Assume that the war on poverty also entails (particularly in MICs) a correction of distribution patterns
Increasing multi-polarity	New sense of the principle "common but differentiated responsibilities"	a) Support the involvement of MICs in efforts to correct international inequalities through South-South Cooperation  b) Promote rules and entities for global governance
Growing space for International public goods (IPGs)	Need to set agendas and shared efforts for common problems	a) Support the active involvement of MICs in the IPG agenda

## 3. WHY COOPERATE WITH MIDDLE-INCOME COUNTRIES



The need to respond to the previously mentioned changes in the international scene poses major challenges for the development cooperation system.

### 3.1. MAXIMIZING DEVELOPMENT IMPACT: AN INCENTIVE-BASED APPROACH

In that regard, the system has two opposing options: one is to accept a comprehensive perspective which covers a significant part of the developing world, with a differentiated agenda based on each country's conditions which enables Southern countries to assume common but differentiated responsibilities, and connects the development agenda with the international public goods' agenda. The other alternative is to turn aid into a policy specializing on the fight against extreme poverty, focused on LICs (and fragile states), which is very centrally led by traditional OECD donors (with minor contributions from other donors).

Some analysts think that the second option is the most suitable. Since aid resources are scarce, these should be focalized on fighting poverty in poorer countries (the Collier's bottom billion, 2007), preventing funds from being scattered over diverse purposes or used in certain countries (such as MICs) that have greater relative capacities. Implicitly, it is assumed that these countries have sufficient resources to deal with their own problems by themselves, including the eradication of poverty.

Nevertheless, the above proposal includes some questionable aspects. First, it promotes an excessively simplistic view of the development agenda, as it fails to include goals –other than the struggle against extreme poverty – that should also be contemplated

if one seeks a more equitable and sustainable distribution of development opportunities on a global scale. Second, it overestimates the capacity of MICs, without realizing that many of them suffer from serious structural challenges, as well as bottlenecks (and even reversals) in their development processes. Finally, it fails to realize that the redistributive goal, although it is required, should not be the only purpose of the cooperation system; this should also be geared towards maximizing the development efforts made by donors and recipients, by creating an appropriate incentive framework. Taking these three elements seriously leads to conceiving aid as an integral policy, complex and differentiated according to each country's conditions, including those MICs with severe vulnerabilities.

In abstract terms, aid should play a two-fold role: it should promote the redistribution of income and opportunities for progress globally, and, it should introduce incentives to maximize the efforts and development achievements of all countries involved. Both goals can be compatible, but they are clearly distinct. In comparative terms, the first role is more relevant in the case of poorer countries, where the transfer of aid resources covers a major share of the recipient's social expenses. The second role is the most prominent in the case of MICs, where aid is a relatively minor source of financing.

This implies that, in the bulk of MICs, if aid has an impact, this is not because of what it finances directly. Instead it is a result of the sort of stimuli for change it promotes in the affected countries (Kharas



et al., 2011). That is, because of its catalytic, change-promoting effect. This means that aid should play one (or a combination) of these four roles:

- Mobilizing (and leveraging) additional resources and capacities, which otherwise (in the absence of aid) would be hard to mobilize.
- Alleviating some of the restrictions that block or hinder change processes in developing countries
- Operating as an assurance and risk reduction mechanism to face uncertainty.
- Acting as an incentive, increasing potential benefits associated with positive changes for development.

### 3.2. CAN MIDDLE-INCOME COUNTRIES ADDRESS POVERTY BY THEMSELVES?

The high concentration of poverty in middle-income countries has led some to wonder if we should not be more concerned about helping poor people (wherever they live) instead of focusing on assisting poor countries. While Collier (2007) insists on the second option, in some occasions Sumner (2010) appears to suggest the first. If the volume of poor people is what matters, then MICs should become the preferential recipients of aid. However, this logic is not correct: in a world made up by sovereign political communities, aid allocation cannot be carried out regardless of the capacities that each community has in order to deal with its own problems. Aid must be conceived as a subsidiary resource which complements and stimulates national capabilities, instead of a factor used to replace those capacities.

If this principle is accepted, the relevant issue in aid allocation is not so much the number of poor population in a given country, but rather the relative

effort required by that country to eradicate poverty. To boost that effort, one must not consider the number of existing poor, but rather: i) the relative poverty rate, this is, the ratio of poor people to the overall population (the headcount ratio); and ii) the relative severity of poverty, meaning the distance between the poor's purchasing power and the poverty line (the poverty gap).

This can be seen through an example. Pakistan (a middle-income country) has over 37 million people living under the poverty line, while in Burkina Faso (low-income country) the number of poor people is five times smaller, affecting 7.5 million individuals. However, with regard to their population, the poor make up 44.6% of the overall population in Burkina Faso, while in Pakistan that ratio is less than half: 21%. Therefore, poverty incidence is much greater in the African country. This factor is important to determine the relative effort required in each case to reduce poverty.

It is also necessary to determine the severity of poverty, that is, the distance of poor people from the poverty line (which is what the poverty gap measures). In Burkina Faso this ratio is four times greater than in Pakistan (14.7 versus 3.5), which means that the effort required to take a person out of poverty is, in the first case, four times greater (Chart 6). If one simultaneously considers the relative proportion of the poor and the severity of poverty, in connection with the resources of that population stratum on which the tax system can operate (usually the richest quintile of the population), we will then obtain a relative measure of the redistribution effort that would be required to eradicate poverty (the percentage of the richest people's income that would need to be transferred to the poor in order to raise them above the poverty line). This effort is 16 times greater in Burkina Faso than in Pakistan.

**TABLE 6: RELATIVE EFFORT REQUIRED TO ERADICATE POVERTY**

COUNTRY	GNI (MILLIONS)	POPULATION (MILLIONS)	POOR POPULATION	POOR AS % OF TOTAL POPULATION	POVERTY GAP	% OF INCOME OF RICHEST 20% NEEDED TO ERADICATE POVERTY
Pakistan	401,854	167.4	35,229,851	21.04	3.5	0.35
Burkina Faso	17,341	15.9	7,129,077	44.6	14.7	5.71

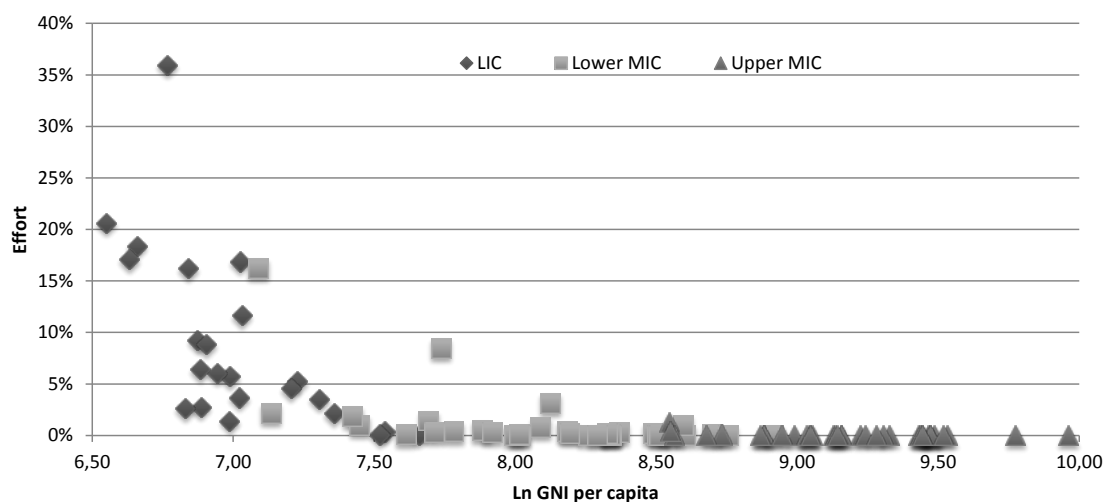
*Source: prepared by author based on World Bank, World Development Indicators*

The points raised in the previous paragraph may be generalized to any developing country for which there is available data, considering the two most widely used poverty lines (1.25 and 2 dollars spent per day)<sup>7</sup>. The application of this criterion reveals that LICs present higher ratios (Figures 2a and 2b). And so, irrespective of the geographical distribution of poverty, if aid intends to support the national effort to eradicate this social scourge, the priority of LICs in resource allocation is once again confirmed. The bulk of aid should be directed towards the poorer countries. Nonetheless, this data also indicates that some MICs (particularly lower middle-income ones) present high ratios (e.g.: Ghana, Republic of Congo, Nigeria, India, Pakistan, Zambia or Namibia). Abandoning these countries to their fate is a way of prolonging the problem, given their inability to assume the redistribution effort required to eradicate poverty by themselves. In such cases, international aid would be justified.

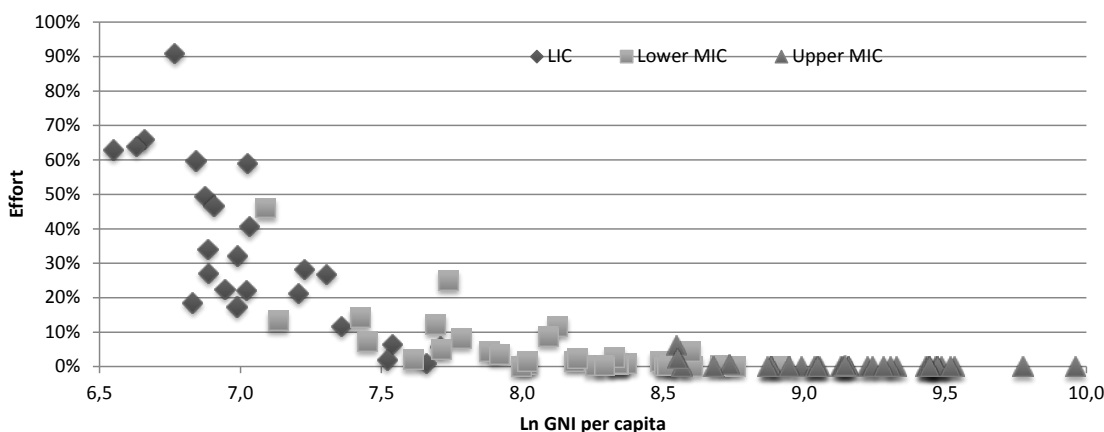
A similar conclusion is drawn by Ravaillon (2009), based on estimations of the marginal tax rate that should be applied to the rich population in order to finance poverty eradication. To this end, he defines “rich population” as that which is above the poverty line in any country being considered (that is, someone who would not be considered poor based on any standards). Next, he estimates the income extraction that should be applied to such stratum in order to locate the entire poor population above the 1.25-dollar line. He calls this ratio the “marginal tax rate”. In his study, most MICs have moderate marginal tax rates (lower than 25%), revealing that there is sufficient space to roll out stronger redistribution policies.

Conversely, most low-income countries present marginal rates which are hard to afford (above 70%), reflecting their limited space for redistributive action. Among middle-income countries there are

**FIGURE 2A: REDISTRIBUTION EFFORTS TO ERADICATE POVERTY (1.25 DOLLARS)**



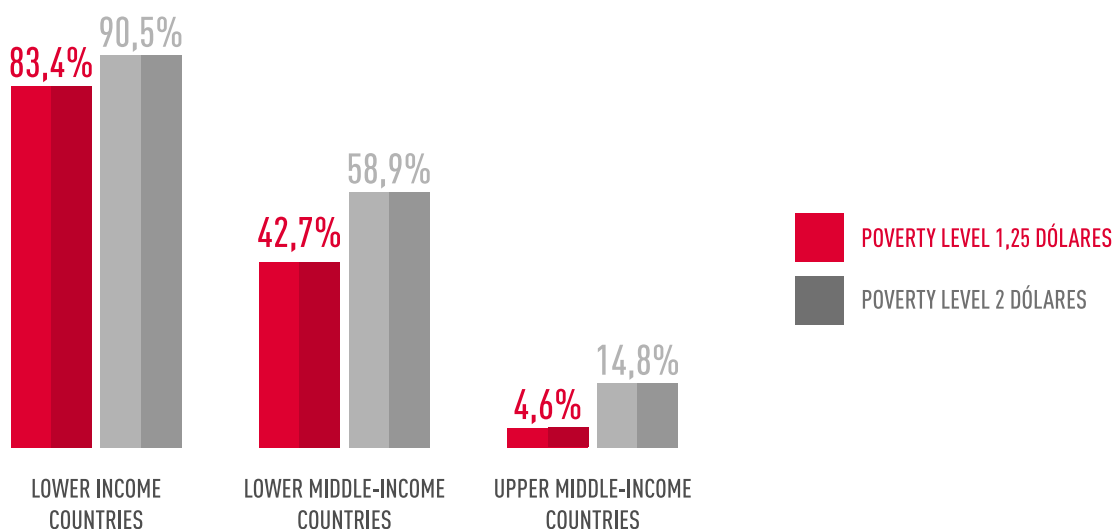
**FIGURE 2B: REDISTRIBUTION EFFORTS TO ERADICATE POVERTY (2 Dollars)**



Source: prepared by author based on World Bank, World Development Indicators

<sup>7</sup>This must be understood as an approximation, since the cost of eradicating poverty exceeds the mere transfer of resources.

**FIGURE 3: MARGINAL TAX RATE NECESSARY TO END POVERTY**



*Fuente: Chen y Ravallion (2011)*

some cases in which marginal rates present hardly affordable values (such as: El Salvador, Honduras, Algeria, the Philippines and Indonesia). In fact, for lower middle-income countries, marginal rates are around 40%, which is quite high (Figure 3). In the case of MICs with high demographic density and significant contingents of poor population (such as India, Nigeria or Pakistan), this ratio may be as high as 100%.

In sum, despite the poverty concentration found in MICs, LICs should still receive most aid, because they have to make a greater effort in order to eradicate poverty. In a broad group of MICs, there is the possibility –a reasonable possibility depending on the relative cost- to assume poverty eradication by themselves, for which they will need to reduce the existing levels of inequality within their societies. In such cases, it is national governments who are most responsible for this task, by launching social and redistribution policies. Aid cannot be offered to replace this responsibility: it does not seem reasonable for taxpayers in donor countries to contribute to a situation where wealthy segments in MICs escape their tax-paying duties<sup>8</sup>. Nevertheless, in these cases aid could play a minor role by supporting the relevance of such redistribution policies, so that they become a real priority, and by facilitating their design through technical assistance and the exchange of experiences.

However, within the middle-income group there are some countries for which it would be really difficult

to eradicate poverty on their own and in the short term. These countries have a limited margin for redistribution action, because the relative cost of the transfers required to lift those affected out of poverty is simply too high. In these cases, international aid may be required in order to supplement national resources and capacities.

### 3.3. DO MICS FACE DEVELOPMENT CONSTRAINTS WHICH CAN BE ADDRESSED BY INTERNATIONAL COOPERATION?

The persistency of poverty is just one of the many problems which MICs face. These countries also confront structural deficiencies and imbalances which often threaten the sustainability of their development efforts. Their deficiencies are different from those of poorer countries (the so-called “poverty traps”), but their effects may be equally paralyzing. In those cases problems are not so much the result of absolute deprivations, but from specific bottlenecks faced by the productive and institutional change processes for development: this kind of situations are called “middle-income traps” (we will return to this question later on). These problems, presented repeatedly, lead countries to become blocked, hindering their convergence towards higher-income levels (Aiyar et al., 2013; Agenor and Canuto, 2012; Fallon et al., 2001; Alonso, 2007).

<sup>8</sup>This is one reason for not considering inequality (or Gini index) as a criterion for aid allocation or the determination of a country's graduation (this will be discussed later on).

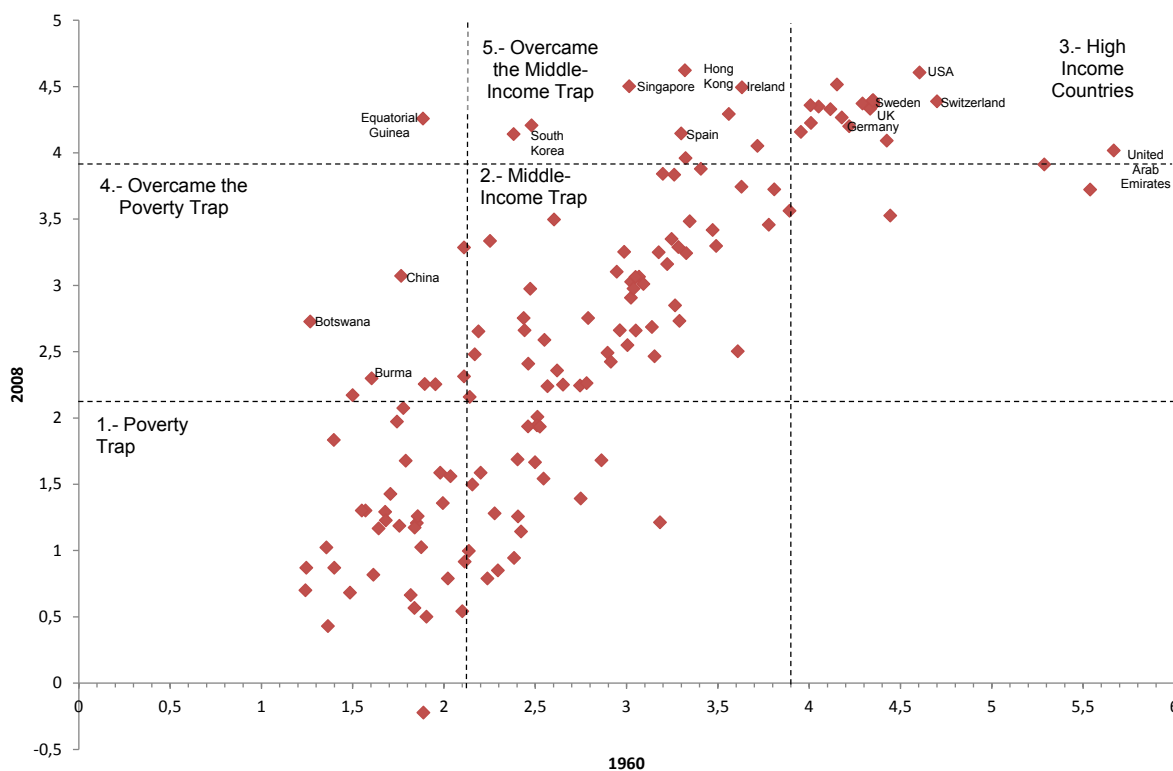
Empirical analysis confirms this view. Many MICs experienced periods –sometimes repeated- of accelerated economic growth. However, few countries have managed to sustain those processes and move towards the situation typical of HICs. In other cases, such acceleration periods were interrupted by severe crisis which affected, in particular, those countries’ governance conditions, the circumstances of their international financial integration and their macroeconomic balance, or their possibilities of sustaining a continuous path of productive change. In fact, out of 101 middle-income countries existing in 1960, only 13 managed to become high-income countries by 2010 (Agenor et al., 2012)<sup>9</sup>.

A simple illustration of this can be obtained by classifying countries on the basis of their relative per capita GDP compared with the United States in 1960 and 2008. Figure 4 classifies countries into several groups, according to their dynamic behavior. Thus, for example, quadrant 3 includes those countries that were high-income in 1960 and still are nowadays (a large part of Western Europe, United States and Australia); conversely, quadrant 1 shows those which

were poor in the past and remain poor in the present: these countries appear to be caught in poverty traps (most countries in Sub-Saharan Africa); quadrant 5 displays the countries which were originally middle-income and have now managed to attain high-income levels (Spain, Korea, Taiwan and Ireland); quadrant 4 shows the countries that managed to ascend from low to middle income (e.g.: Botswana and Mauricio); finally, quadrant 2 shows those countries which were originally middle-income and remain so at present. This means that they could not implement a sustained growth process in their economy to favor a transition toward high-income levels. This group includes a large number of countries, some of which have suffered the effects of middle-income traps.

As noted previously, the fact that a country is caught in a middle-income trap does not mean that it has not experienced episodes of accelerated growth. For example, Figure 5a reflects the evolution of the per capita GDP corresponding to three Latin American countries (Brazil, Venezuela and Argentina), and two European ones (Spain and Ireland). The latter two managed to overcome the middle-income trap and, during the period, they followed a sustained

**FIGURE 4: POVERTY AND MIDDLE-INCOME TRAPS. A GLOBAL VISION.**

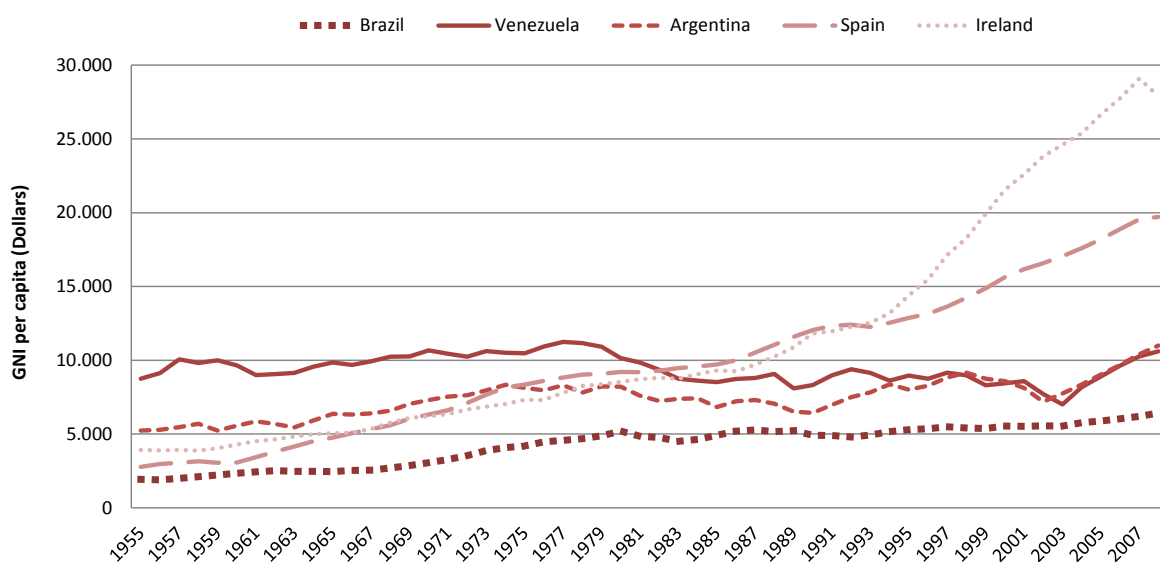


<sup>9</sup>In the last review by the World Bank of 2013, this list was increased with six countries passing into the high-income country category, among others: Chile, Uruguay and Russia.

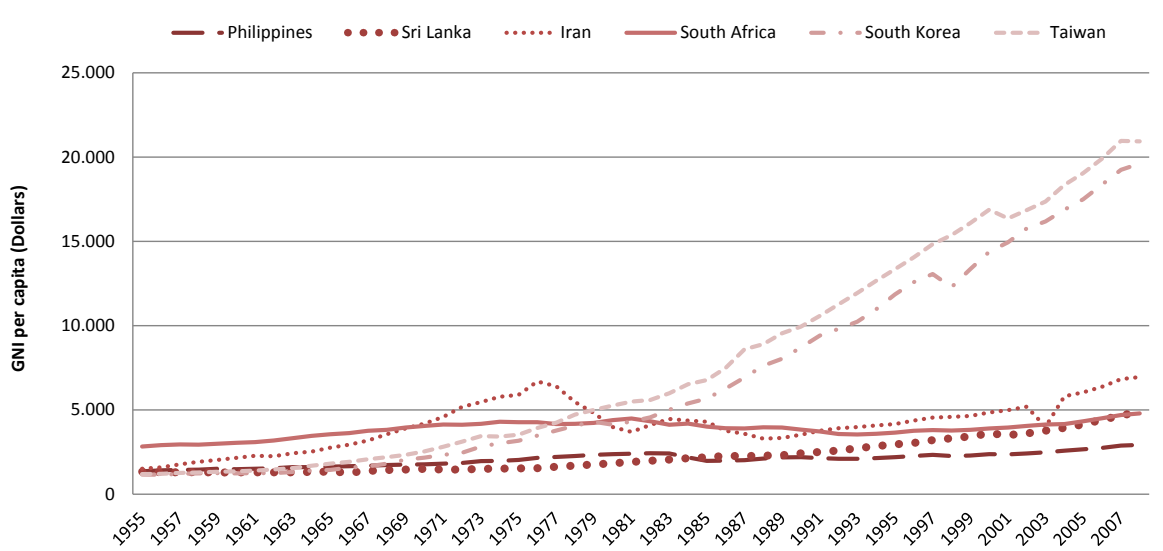
process to converge with HICs. However, this trend was not sustained in any of the three Latin American countries, although some of them experienced occasional periods of accelerated growth (such as Brazil in 1968-1974 or Argentina in 1955-1960). Likewise, Figure 5b shows four countries that have not managed to ascend from the middle-income status (Iran, Sri Lanka, Philippines and South Africa), next to two countries with successful convergence dynamics (South Korea and Taiwan). Again, the first group's failure does not mean that some of them have not experienced occasional accelerated growth (such as Sri Lanka in 1976-1983 or Iran in 1966-1977).

Therefore, the problem is not achieving growth, but rather maintaining a continuous path of growth and social transformation. For this purpose, countries need to be able to tackle bottlenecks occurring in their process of institutional and productive change. International development cooperation can contribute, although unevenly, to this task. The impact of international aid may be significant in overcoming some obstacles --for example, those related to the lack of social cohesion or the low quality of institutions--; also in a limited but not irrelevant way in other cases --e.g.: by promoting innovation and technology transfer - and in a minor way, to solve a third set of problems-- for example, the expansion of the space for counter-cyclical macroeconomic policies.

**FIGURE 5A: MIDDLE-INCOME PROGRESS AND TRAPS**



**FIGURE 5B: MIDDLE-INCOME PROGRESS AND TRAPS**



Source: Maddison

### 3.4. PROMOTING INTERNATIONAL COOPERATIVE ACTION FOR COMMON PROBLEMS

The reasons that justify cooperation with MICs are connected not only with overcoming the internal challenges which affect these countries, but also with the support that these countries require to be more actively involved in the management of common global problems. The increasing presence of dynamic powers from the developing world on the international scene, together with the increasing heterogeneity of this group, implies the need for a more shared and modulated distribution of the governance responsibilities in the international system. A new conception of the “common but differentiated responsibilities” principle should be adopted; this would actively involve the more developed countries in the South (MICs) in a more committed cooperative action at a global scale. One of the tasks of development cooperation should be to create the conditions and establish the incentives for that involvement to be effective.

There are two areas in which this promotion of global cooperative action by MICs seems to be particularly relevant: the provision of global and regional public goods, on the one hand, and the correction of poverty and the promotion of international development (through the South-South and triangular cooperation), on the other. These spheres necessarily require the contribution of MICs, if a more inclusive and effective global governance structure is to be built. Nevertheless, these countries do not always find the existing governance structures to be suitable to making their voices heard, which would be a mandatory condition for them to be more committed to undertaking global tasks. At the same time, these countries have limited resources and experience to deal with those international responsibilities. International development cooperation could help make the shift towards assuming greater international commitments occurs in the best way possible, and with the lowest costs for the affected country.

## 4. AID ALLOCATION AND COUNTRY GRADUATION: THE CASE OF THE EU



As argued in the previous section, there are good reasons to maintain an active policy of development cooperation with MICs. However, many international donors (both bilateral and multilateral) have tended to withdraw from this type of countries. In many cases this was a result of applying some formal graduation criteria based on per capita GDP; in other cases, it was simply because they placed a high value on that indicator in their aid allocation process.

### 4.1. COUNTRY CLASSIFICATION

Resorting to GDP as the main criterion for aid allocation is clearly debatable. Although it is a synthetic indicator for many other factors, per capita GDP fails to cover the totality of the relevant aspects needed to identify a country's situation, and the average it expresses is frequently not representative enough of the diversity of situations within a country.

This is especially relevant in MICs, as they are characterized by a remarkable internal heterogeneity in their productive, social and regional spheres. Inequality in living conditions is often quite stark, depending on social class, region, ethnic group or gender; and productivity levels vary according to the sector, capital origin or location of a given investment. As a result, the country average values may conceal the existence of markedly different realities; such contrast should be taken into account in order to carry out an appropriate diagnosis of a country's development possibilities.

In view of these deficiencies, it is not uncommon for many analysts to seek a wider combination of indicators to build a more appropriate taxonomy for country classification (Tezanos and Sumner, 2011; CEPAL, 2012). From the analytical point of view, in terms of a rational ordering of highly diverse

realities, there is nothing to object to these efforts. However, extreme caution should be exercised if one intends to use these classifications to identify development agendas to be prescribed for each group, or to derive criteria for aid allocation and graduation.

With regard to setting of development agendas, a simple taxonomy, no matter how careful it is, cannot possibly identify the diversity of country situations and the priorities that should be established in each of them. Replacing three large blocks (low, middle/low and middle/high income) with five or six alternative groups based on a more diverse combination of indicators may be useful from an analytic standpoint, but it is not likely to respond to the actual need to set priorities that development cooperation to address. Agenda setting must be performed differently for each country, identifying the key points of its development process, and any bottlenecks to be tackled in each case. No taxonomy can excuse policy-makers from carrying out a specific analysis of the particular reality of each country; as Hausmann et al., (2004) and Haberman and Pradutt (2011) suggest, development diagnosis must be the result of a careful and accurate analysis of each national reality. The developing world has become increasingly heterogeneous, and development cooperation should be prepared to



manage such diversity, by adapting its solutions to the circumstances of each case.

In another vein, it would be overly pretentious to seek an algorithm that would automatically determine the aid allocation process. The idea behind this is to reduce discretion and prevent the fallibility of policy-makers. However, such an algorithm is not easy to build (given the diversity of factors to consider), and the mechanical application of a numerical criterion does not seem to be a desirable objective, given the highly contingent nature of the aid allocation process.

In line with its predominantly bilateral character, aid allocation is influenced, to varying degrees, by factors connected to the identity and interest of the respective donors. Recipient's needs, regardless of the way they are measured, also influence decisions, given the redistributive nature commonly attributed to aid. Finally, a third group of less precise factors (such as fashions, mimetic behavior, historical inertia, etc.) also affect the resource distribution criteria. Studies on aid allocation confirm the existence of such a heterogeneous set of factors in the donor decision-making process (Neumayer, 2003; McGillivray, 1989 and Van der Veen, 2011, among others).

In view of their complexity, it is difficult (and maybe not entirely appropriate) to translate all of these factors into an algorithm, a sort of precise rule for allocation. Given the complexity and fluid nature of international reality, it seems appropriate to provide adequate margin in the decision-making process so that managers can carefully ponder a set of changing, and even unforeseen, factors. The purpose should not be to use an allocation rule to restrict the independent judgment of public authorities, but rather to build a basis for them to argue their decisions rationally. The identification of technical criteria may assist in the decision-making process, but not because it exempts managers from their duty to decide, but because it enables such decisions to be as well-informed as possible.

Recipient's per capita GDP can be a part of the criteria considered for aid allocation, but it should never be the only, or the predominant, criterion. When seeking supplementary criteria, one should avoid those which may act as a source of perverse incentives, as these would ultimately affect the effectiveness of aid. For example, resources should not be allocated based on recipient inequality

levels, as this would entail supporting those who are less concerned with improving their distribution patterns; nor it should be granted to compensate the weak country's tax effort, as this would represent a disincentive to the creation of a solvent tax system, which is nonetheless essential for development.

It is key to seek allocation criteria in line with development incentives. When searching for such criteria, two groups of factors (not necessarily alternative) appear as particularly appropriate. First, criteria based on structural vulnerabilities that hinder a country's development and are partially beyond the government's control (this is measured, for example, through the economic vulnerability index, which is part of the definition criteria for the Least Developed Countries, LDC). For example, the fact that a country is distant from economic activity centers, it is very small in size, does not have a diversified production base, or is exposed to recurrent natural disasters are issues that reduce a country's possibilities for development, and are under the government's control only to a partial extent. In these cases, aid does not generate perverse incentives because it is only aimed at partially offsetting the disadvantages which affect these countries.

A second type of criteria which does not create perverse incentives are those connected to the recipient's development efforts, in such a way that aid rewards and encourages positive behavior. For example, aid should not be granted on the basis of existing inequality, but it could be granted based on the effort made by the government to correct such inequality (measured through the content of its public policies, for instance). In this last case, what is important for the criteria is to be associated with efforts and achievements in terms of development, and not with the type of policies applied, as this would unduly restrict the autonomy of recipient governments (by imposing an implicit type of conditionality).

#### **4.2. THE COSTS OF GRADUATION**

A number of donors (particularly multilateral ones) have established clear criteria to determine a country's eligibility or subsequent graduation in the access to resources. Within those criteria, per capita GDP usually occupies a central position, a donor sets a per capita income threshold beyond which the country is no longer entitled to receive any more resources. Such behavior, raising legitimate

complaints from many MICs, has some drawbacks worth considering.

The very logic of graduation is controversial, as it creates problems both in terms of equality and incentives within aid policies. It affects equality because it subjects a reality that is continuous in nature –this is, the level of development of countries– to a dichotomous logic: eligible versus non-eligible. It also has an impact on incentives because withdrawing aid from countries making progress does not help promote their national development efforts.

Beyond these aspects, the fact that several donors apply the same graduation criterion (for example, recipient upgrade to the middle-income category) may lead to a simultaneous and uncoordinated withdrawal of resources, which could affect a country's conditions for stability and progress. This is not a hypothetical case, as there are many donors (particularly multilateral) who base graduation criteria on per capita income, setting the threshold similar to that defined in the middle-income category. Consequently, Salgado and Waltz (2013) estimate that between 2013 and 2030, 41 countries will be graduated from IDA (the World Bank's concessional window), 15 will graduate from the African Development Fund, 15 from the Asian Fund, and around 38 from the GAVI Alliance. The simultaneous graduation from many organizations will cause some MICs to lose between 25% and 40% of the international aid funds they received. This sudden withdrawal of funds, apart from severely limiting the aggregate volume of resources available for the country, can affect the composition of spending, as it has a more central impact on those components –such as education or health– for which aid funding is crucial. The costs of both processes could be considerable.

Additionally, the simultaneous application of graduation processes can cause another undesirable effect, because it forces donors to concentrate their resources on an increasingly small number of countries, with a disproportional increase in the weight of aid in their respective public finances. Several studies confirm that aid is subject to diminishing returns, in such a way that its impact can become negative when its share of external resources reaches high levels. Dependence on aid constitutes

a serious issue, one that could be intensified if the range of recipients is reduced (Glennie, 2008, Alonso et al., 2012). There are various reasons that explain this relation: the adverse effect of foreign resources on competitiveness (the “Dutch disease” effect), the recipient's limited absorption capacity, the negative impact of resource availability on the tax system, the diversion of local human and technical resources that can be generated by aid administration or, ultimately, the negative effect on the quality of local institutions and their accountability to citizens. Regardless of how it happens, an increase in the aid dependency levels of some countries would be clearly negative.

In view of the costs associated with the graduation process, an improved system would replace graduation with gradualism; that is, aid should back up national efforts, modulating the intensity of support (and its contents) according to a recipient's capacities and requirements. This involves paying more attention to poorer countries, but it does not excuse donors from granting aid to the most vulnerable MICs, while supporting their efforts and consolidating their achievements. Also, support should be maintained until the probabilities of development reversal are considered to have died out; and this should not be measured only via per capita GDP. At the same time, the aid withdrawal process should be gradual, keeping the affected country under observation, in order to avoid any reversals of their development achievements.

In sum, if donors want to set down eligibility and graduation criteria, the latter should be built, first, through a broad range of indicators that offer a rich perspective which is as comprehensive as possible, of a country's conditions. Second, criteria should be selected carefully, in such a way that they do not include limitations that may be the result of a governments' own actions (because in such event we would be rewarding irresponsible behaviors on the part of the beneficiary), and do not entail a penalization of development efforts (because here donors would be introducing perverse incentives into the system). Finally, a careful transition process should be outlined, by defining alternative cooperation mechanisms for countries eligible for graduation. During this transition period, donors should monitor countries to make sure that aid withdrawal does not entail serious costs to their development processes. An example of this careful

and watchful procedure is the one established for the graduation process of the Least Development Countries (LDCs)<sup>10</sup>.

### 4.3. A NOTE ON THE EU

The new EU development policy, based on the communication, *Increasing impact of EU development policy: An agenda for change*, aims to apply differentiated criteria (preferences in aid allocation and diverse instrumental offers for various country groups), incorporating a graduation process for access to donations by a broad group of upper middle-income countries, including two lower middle-income countries. All of this is accompanied by a marked preference for redirecting funds towards low-income countries, LDCs and fragile states.

The subject is of interest, as it refers to the treatment that should be given to MICs, and it affects a wide group of traditional Spanish cooperation partners in Latin America<sup>11</sup>. It is true that graduation in resorting to aid does not mean that these countries are excluded from access to other types of support mechanisms, through the thematic and regional programs of the Development Cooperation Instrument (DCI), and other types of instruments with a lower level of concessionality. However, the lack of defined priorities in such mechanisms makes that option seem like a meager consolation for excluded countries (Herbert, 2013 a /b).

The arguments that justify such decisions respond to the search for greater selectivity in international actions, a more precise identification of the added value offered by Community cooperation, and complementarity with development policies of partner countries. The pertinence of these objectives is hard to refute; the problem lies in whether the execution of the proposal is properly designed. In this regard, four critical points that should be noted:

- First, the new proposal confers a prominent role to per capita GDP (and, to a smaller extent, to country size) as a criterion

both for aid allocation and graduation of countries. We have already mentioned the severe limitations entailed by this criterion in guiding aid allocation decisions. The European Commission is aware of these limitations and suggests, in a somewhat imprecise manner, the possibility of considering additional criteria such as the Human Development Index (HDI), the economic vulnerability index, aid dependence, the country's economic growth, or its capacity to attract foreign investment. But the truth is that these other criteria, which are very heterogeneous, are not accurately articulated in an appropriately built basis for decision-making. It is therefore not surprising that the European Parliament has submitted a more concrete proposal, suggesting a series of supplementary criteria to define exceptions in the country graduation process. Although not all proposed criteria are appropriate, the idea of drawing attention to the limitations of the excessive prominence of per capita GDP is entirely relevant<sup>12</sup>.

- Second, the Commission opts for the (perhaps excessive) use of categories which incorporate countries of differing conditions. Of course, this critical judgment could be applied to the categories established on the basis of per capita GDP (low, lower middle and upper middle), but also to the LDCs or fragile states. The latter category is quite controversial, and contains a remarkable diversity of situations (Harttgen and Klasen, 2012). The same could be said about the LDC group which, in spite of their denomination, comprises as much as 15 lower middle-income countries, two upper middle-income countries and one high-income country (as well as all 31 low-income countries). The internal heterogeneity of these categories makes them a very deficient instrument

<sup>10</sup> The graduation process of a country as a LDC is prolonged in time through subsequent stages where monitoring is prepared and provided to the affected country. Specifically, after verifying that a country is eligible for graduation, three years are given to define the "impact assessment" of the decision and to prepare a "vulnerability profile" for the country; in year 3, such inputs are analyzed, as well as the report made by the country itself and, if applicable, the graduation proposal is forwarded to the CDP and ECOSOC and notified to the UN General Assembly; in years 3-6 the transition strategy is prepared and country follow-up is conducted by DESA; if everything is done correctly, in year 6 (or 3 years following the decision by the General Assembly), the decision is taken to graduate the country; and, finally, the application of the transition strategy is extended over subsequent years, as well as the monitoring of the country's performance by means of triennial reports (see CDP, 2008).

<sup>11</sup> Upper middle-income countries that graduate are: Argentina, Brazil, China, Chile, Colombia, Costa Rica, Ecuador, Kazajstan, Iran, Malaysia, Maldives, Mexico, Panama, Peru, Thailand, Venezuela, and Uruguay. The two lower middle-income countries eligible for graduation would be India and Indonesia.

<sup>12</sup> It is suggested that a middle/high-income country might have access to donations if it meets the following criteria: i) being below 0.75 in the HDI; b) having a poverty ratio above 10% (based on the 2-dollar poverty line); iii) being above 4% in the poverty gap index; and iv) having a Gini index over 45%. Just by way of example, both Ecuador and Colombia would fully meet these criteria. Indicators in Ecuador are: 0.725; 28.6; 4.02; 49.3; and in Colombia: 0.722; 37.2; 6.79; 55.9.

to determine aid allocation or graduation criteria.

- Third, the design of the graduation process must be accompanied by a precise definition of alternative mechanisms to which graduate countries can resort. The idea is to make the graduation process easier, removing the uncertainty experienced by countries with the suppression of one of their funding sources. The Commission cites such alternative mechanisms, but there is no clarity as to the implications of access to said instruments by affected countries. That is, the graduation design, instead of reducing uncertainties for the affected countries, actually increases them.

- Last, as was previously pointed out, all graduation processes should be accompanied by a transition path, where donors monitor the impact of graduation on the affected country, in such a way that compensatory or provisional mechanisms can be established when required, or even the reversal of graduation in more serious cases. None of this was conceived by the Commission.

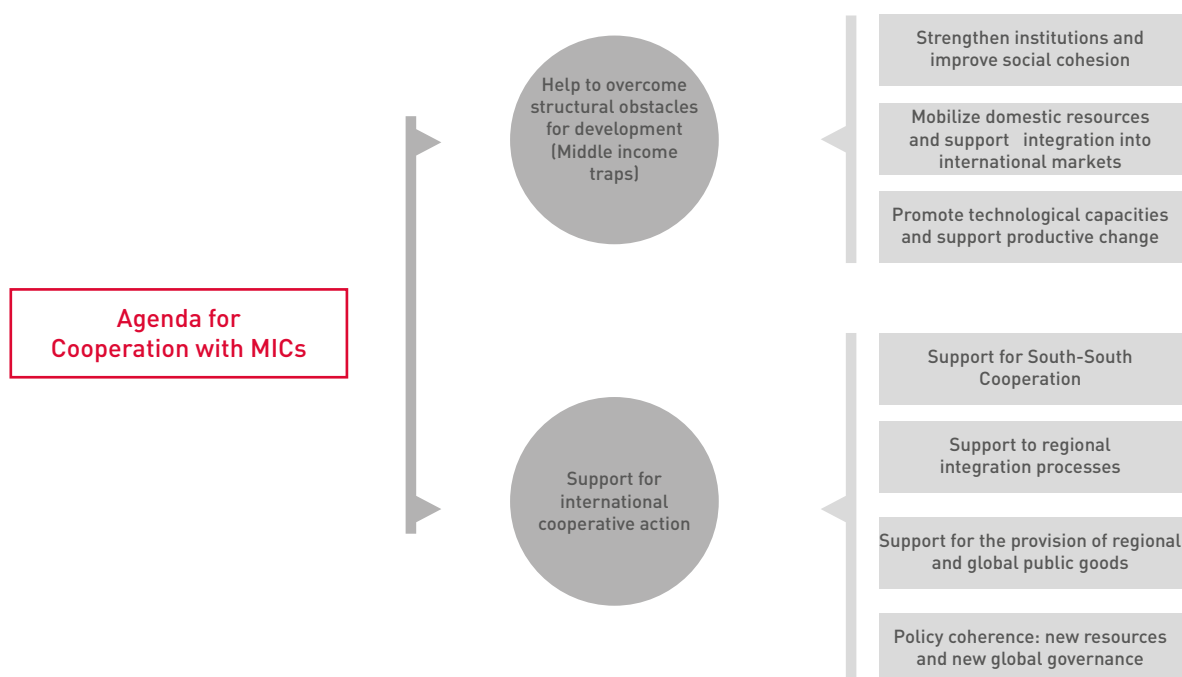
In sum, the EU set out a path of greater selectivity which cannot be criticized, but the implementation of this policy is grossly inadequate.

## 5. THE MIC AGENDA: FACING MIDDLE INCOME TRAPS AND PROMOTING INTERNATIONAL COOPERATIVE ACTION



The previous analysis suggests that cooperation with MICs should be organized mainly around two major purposes: to help countries overcome the obstacles that restrict their development (tackling the middle-income traps), and to support their efforts to assume a more prominent role in international cooperative action. Table 7 (further developed in the Appendix) provides a synthetic view of the areas in which these purposes may be implemented, and the role that the international cooperation can play in them.

**TABLE 7: AGENDA FOR COOPERATION WITH MIDDLE-INCOME COUNTRIES**



## 5.1. OVERCOMING THE MIDDLE-INCOME TRAPS

Any attempt to identify the problems of MICs must begin with a note of caution about the vast heterogeneity that characterizes this group of countries. The generic “middle-income” term comprises a series of very diverse countries in terms of their size, achievements and potentials. As a result, supposedly unique and universal diagnoses or treatments are not what is needed; agendas must necessarily adapt to the circumstances of each case.

However, once this caution is noted, it is possible to identify certain areas in which, quite often, there are problems that seriously affect the chances for development of MICs: it is around these problem areas –institutional change and social cohesion, financial integration and macroeconomic stability, and productive, technological and energy patterns– where the middle-income traps emerge. The international literature, although very recent<sup>13</sup>, has tended to focus on the third of the traps considered here (productive change), but there are good reasons and a broad series of historical experiences which suggest that the other two (governance and financial traps) are major source of blockages in the development process of middle-income countries.

### a) The Governance Trap

The first trap is associated with a country’s governance conditions. As countries progress, they require more complex institutions which are capable of dealing with the coordination issues inherent to more developed economies and, at the same time, to meet the needs of societies that are more demanding with the country’s governance situations. In other words, the development process also requires a path of institutional change. Both processes do not always move at the same pace, and frequently, advances in economic and social areas are not accompanied by a parallel renovation of the institutional framework, creating a problem that may affect the sustainability of the development process. This situation particularly affects MICs, as they are nations which undergo the most accelerated transformations.

This is not a merely technical matter. Frequently, the problem lies not only in the weakness and limited efficiency of institutions, but also in their reduced credibility, causing citizens not to regard them as an appropriate channel for managing collective issues. This situation is fueled by the extraordinary levels of inequality and the social/regional fragmentation

typical of some MICs. Such acute inequality and lack of social cohesion, firmly rooted over time, becomes a corrosive element for institutional legitimacy. This factor is particularly serious in countries with high horizontal inequalities (inequality among groups), within an environment of very limited social mobility.

In these cases it is hard to build institutions that are both solid and socially rooted. As a consequence, countries are less capable of providing the public goods demanded by society; to deal with the distributive tensions derived from development processes; to face the external shocks that may affect the economy; or to carry out coordination and market development tasks inherent to the State. In other words, institutional weakness damages the governance of development processes, making it difficult to sustain the process of growth and social change.

Institutional weakness is also reflected in the fragile nature of the fiscal contract on which the State is supported. If citizens question the legitimacy of public institutions, they are not likely to be motivated to pay taxes to finance them. Consequently, tax effort is low, tax evasion levels are high, and the financial difficulties faced by the State are recurring. This generates a vicious circle which is very difficult to escape: since public financial capacities are low, governments find it difficult to offer the public goods demanded by society, thus weakening their legitimacy; at the same time, such limited institutional legitimacy causes citizens not to feel committed to supporting the State with their taxes (Alonso, 2010, Alonso et al. 2011).

In this context, strengthening the institutional framework and improving social cohesion should be one of the key focuses of international cooperation. The aim should be not only to improve institution efficiency, but also their capacity to articulate collective action, which is necessarily related to institutional credibility and legitimacy. The improvement of transparency and accountability is a part of these aspects, as is the fight against corruption and the strengthening of the rule of law.

As pointed out before, consolidating institutions is difficult unless social inequalities are corrected and social and regional cohesion are promoted at the same time. International cooperation can play a role in this task. Many MICs are trying to consolidate their public education, health and social protection

<sup>13</sup> The term “middle-income trap” was first used by Gill, Kharas et al. (2007) and subsequently reflected in the Growth Report by the Commission on Growth and Development (2008) and Spence (2011). It was simultaneously used by Alonso (2007) under a different name (“progress traps”)



systems. The quality and universal accessibility of these services, at least on a basic level, is an important factor in favoring social inclusion and combating inequality. International cooperation can support these efforts through various instruments (budgetary support, sectoral approaches or projects), based on each country's circumstances. This action is compatible with more focused interventions geared towards correcting exclusion in the most vulnerable sectors (as done, for example, by conditional transfer programs). Equally, international cooperation can play an active role in correcting gender inequalities, by supporting public equality policies and increasing their effectiveness. Donor experience in this field may be relevant.

A key sector for the promotion of social mobility and equity is education. In MICs, the levels of access to primary education are relatively high; however, the quality of this service is low and, above all, the coverage and quality of secondary education is deficient. In fact, it is often at this educational level where one finds the mechanisms that cause social segmentation, restricting the role of education as a promoter of social mobility. International cooperation can actively work in this area, supporting efforts made by governments to reinforce the quality and accessibility of secondary education in MICs.

Apart from social fragmentation, some MICs are characterized by the presence of a clear lack of regional cohesion. International cooperation should consider this aspect when deciding on which regional context it should focus its efforts. At the same time, available evidence suggests international cooperation should actively support those public policies which aim to correct imbalances in income distribution between regions.

A compulsory aspect part of this issue is to build a more demanding claimant between the citizens and the State, which consists in the design and application of a more demanding fiscal contract, providing the State with resources to finance public policies and, at the same time, evidencing the willingness to distribute the tax burden according to the taxpayers' ability to pay. In this area international cooperation can also play a significant but minor role by providing technical assistance and the exchange of experiences for the design of the tax system and in the improvement of the tax administration.

Finally, this improvement of institutions should go hand in hand with another parallel objective, aimed

at strengthening local civil society and its channels of pressure and expression to institutions, so that they can have an impact on the public agenda, and claim the transparency and accountability they are entitled to. In view of the levels of social fragmentation and distrust of institutions, this active role of civil society is absolutely crucial in stimulating a process of change within these countries.

### **b)The Financial Trap**

The second problem area for the development of MICs derives from the sometimes difficult compatibility between the increasing integration of these countries into the international financial markets and the possibility to preserve the conditions of macroeconomic stability required for sustainable growth. These countries are typically characterized by their tendency to become indebted in international financial markets. However, within an environment of capital account deregulation, these markets tend to accentuate the cyclical behavior of economies, giving rise to recurring episodes of macroeconomic instability, with serious costs both in social terms and in the economies' capacity for growth. With high debt-to-GDP ratios, securities denominated in foreign currency (and, sometimes, in limited-term bonds), and a reduced fiscal space to maintain counter-cyclical policies, these countries are subject to the influence of the animal spirit of international investors. In cases of greater tension, such instability episodes result in severe financial crises, associated with the over-accumulation of debt, bankruptcy of national banking systems, or unsustainable exchange rates (Ocampo, 2003, 2011 and Ocampo & Griffith-Jones, 2007).

However, the severity of this financial trap seems to be lower today than in the past. As a result of the expansive tone of the previous economic cycle, capital markets provided funding under acceptable terms to several MICs. Additionally, current account surpluses, in many cases stimulated by the commodities boom, allowed these countries to increase their official reserves and international assets in an unprecedented manner. In fact, the emerging market economies have come to hold nearly two thirds of global official reserves. This financial asset accumulation (a sort of self-insurance against international financial risks) has provided many of these countries with greater room for maneuver amidst changing market conditions. In any case, in order to reduce the risk of falling into a financial trap, progress should be made in these countries in at least three areas. First,



domestic resources should be mobilized, promoting national savings to avoid excessive dependence on international funding, which intensifies the risks of contagion in the event of a crisis. For this purpose, it is necessary to preserve macroeconomic balances, enhance the national banking system and promote the development of financial markets.

Second, the margin for the design of counter-cyclical macroeconomic policies must be expanded. This involves strengthening the State's fiscal capacity and setting rules to preserve stability throughout the cycle, combining surplus periods, in peak times, with public deficit periods, when required. Resorting to Stabilization Funds which accumulate part of the trade surpluses obtained during peak times in export product prices is another resource along the same line. It is not easy to promote counter-cyclical policies within an environment of full deregulation of capital movements. Instead, international experience reveals that the space to design this type of policies is expanded when some capital account regulation is applied.

Last, progress is also required in the correction of existing asymmetries within international financial markets. The efforts launched by the G-20 for this purpose as a result of the crisis are manifestly incomplete. In this respect, it seems necessary to continue making progress in the design of solutions to prevent the presence of spaces which are opaque to regulation and monitoring, and to modify the pro-cyclical tone typical of capital markets. Although the IMF capital expansions are on the right path, there is a need for a mechanism that operates as an international liquidity provider, in the required amount and with the required agility during crisis episodes, in order to prevent the triggering of contagion mechanisms. Ultimately, the international monetary system should be reviewed, with the aim of avoiding the asymmetries caused by the current situation, which intensify the recessionary tone of adjustments and promote the accumulation of imbalances between countries.

Development cooperation plays a limited role in solving these issues. Most of them depend on the action taken by national governments, leaving to international cooperation the role of supplying technical assistance and exchange of experiences where required. Some donors have greater capacity for action in the field of international financial regulation; not in vain many of them are part of the G-20 and a relevant part of the more directly

involved institutions (the IMF, the Bank for International Settlements, etc.). In these cases, the responsibility will not lie with the cooperation systems but rather with the action of governments, particularly those of developed countries (through finance ministries or other line ministries). This reveals the importance for MICs of setting global development agendas (not just ODA) and the improvement of policy coherence levels.

### **c)The Productivity Change Trap**

A third group of problems is linked to the difficulties suffered by MICs to maintain a productive and technological transformation process as they move forward in their development process. Traditionally, productive specialization of these countries has been based on natural-resource intensive sectors and unskilled labor. As they advance in their development process, salary costs rise and the economies must move towards more dynamic specializations, which entails applying greater technological capacities and more qualified human resources. These resources are not always available to countries, and they see themselves caught in one specialization that prevents them from making their productivity grow at the right pace, thus hindering the sustainability of their convergence process.

Reaching this goal would require a combined effort: investing in physical and human capital, promoting technological capacities, going from a copy/adaptation model to an innovation model, creating efficient infrastructures and enhancing a climate of fair competition in the markets. All of this should be accompanied by a careful combination of selective and temporary policies for the protection of those sectors considered key, with active support and export promotion measures. Strengthening such a complex process within a context of financial restrictions and weak institutions, is not an easy task. The WTO has not made this task any easier by reducing –but not eliminating– the space for the design of industrial policies in developing countries.

The requirements of environmental sustainability have added new demands to the productive transformation process of MICs. These countries are forced to review their energy model and their technological-productive patterns, if they want their rate of growth (sometimes intense) not to result in costly environmental damages. Countries do not always have access to the technological options needed to advance in these changes in energy and production patterns.

Given their abundance of natural resources, some MICs have reinforced their specialization in commodities. In an environment of increasing international competitiveness, it is reasonable for countries with such abundance of resources to make use of their advantage in the international market. But we should not forget that development requires a process of increasingly complex and diversified specialization, encouraging productive change and the promotion of technological capacities.

In this area, the role of development cooperation is limited, but not irrelevant. Particularly if we consider development cooperation beyond what is strictly reported as ODA. There are six areas where cooperation may be deployed. Specifically:

- First, it can operate by supporting innovative enterprises, by using financial instruments to create seed capital or venture capital corporations capable of promoting and consolidating successful companies. The experience of the OECD and of some developing countries reveals that public policies can boost the offer of these financing mechanisms linked to innovative enterprises. To a similar extent, it can develop and back up business support and training in innovative areas, so as to promote the productive change. Development cooperation can support these policies both through financial instruments and technical assistance.
- Second, it is essential to enhance these countries' technological capabilities, and their creation of innovations and access to productive knowledge. In this area country experiences are very diverse, including the launch of business incubators, business training actions, programs to support institutional mechanisms for the enhancement of technological transfers (university and corporate spin-off), and eventually any international cooperation programs in the field of research, innovation and knowledge networks. In all of these areas, cooperation can act as a mechanism of support and assistance to national policies.
- Third, cooperation can also help to encourage change in the energy patterns of countries, by supporting renewable and non-carbon-emitting sources so that they have a higher share of overall supply. Similarly, cooperation can help to encourage changes

in the more pollutant technological options, benefitting other productive sources which generate less harmful emissions. These processes can form part of sustainable development strategies, to which donors can contribute with their own experiences.

- Fourth, there will not be any productive change unless countries promote the improvement of infrastructure, both physical and technological. Development cooperation cannot assume this task on its own, but it can play a catalytic role in the mobilization of international resources which make funding programs (not entirely reportable as ODA) feasible, allowing for a process of improvement and expansion of infrastructure in this type of countries.
- Fifth, productive change requires skilled manpower, emanating both from professional training and from university education. Governments are responsible for defining education programs, but international development cooperation can support these policies not only with financial resources, but also with technical assistance or university exchange programs. What is crucial in this type of countries is to seek a specific balance in the support to education cycles, paying more attention –unlike in poorer countries– to secondary, professional and university education.
- Finally, it is also important to operate on the regulatory framework of countries, so as to encourage dynamism in their business demography, removing any unnecessary bureaucratic constraints for the creation of new companies, and setting incentives (tax and credit) for those entrepreneurs operating in innovative fields, which, by definition, entail higher risks. Here again, development cooperation has a potential role to fulfill by providing technical assistance.

## 5.2. PROMOTING GLOBAL COOPERATIVE ACTION

The second purpose of international cooperation with MICs is to support and enhance the role of these countries play on the international scene, so that they can take on increasing responsibility in overall

governance. This purpose is unfolded in four preferential areas: supporting South-South cooperation, supporting regional integration processes, promoting involvement in the provision of regional and global public goods, promoting policy coherence and supporting improvements in the representation and voice of these countries in international fora.

#### **a) Supporting South-South Cooperation**

Support to South-South cooperation is a mandatory part in the cooperation agenda with MICs. Through this channel, the restrictive and dualistic view (donors versus recipients) of the cooperation system that dominated in the past is being reconsidered, reflecting the fact that the correction of inequalities is a shared task which all countries are summoned to assume, according to their capacities.

The exact volume of South-South cooperation is not entirely known: deficient records and accountability systems hinder the task of defining a more precise figure, but the estimates made by the DAC in relation to 25 donors is 10 billion dollars (around 8% of overall ODA) in 2010, with Saudi Arabia (3 billion), China (2 billion) and Turkey (1 billion) as the most important providers. Such estimates do not include all new donors from the South; therefore aggregate figures must be higher than those presented here. Anyway, this is an increasing phenomenon, so in 2025 South-South cooperation is expected to reach a volume of 50 billion dollars. This suggests a growing trend, contrary to the trend evidenced by traditional donors in recent years.

In any case, the term “South-South cooperation” comprises very different cooperation models and practices, some of which deserve justified criticism (Alonso 2013, Kragelund, 2008, Zimmermann and Smith, 2011, among others). In spite of this diversity, South-South cooperation incorporates new elements of interest for the international development cooperation system, beyond the resources it mobilizes. First, it is based on a more horizontal relationship, it has greater potential to promote the ownership of initiatives by those involved, generating “double dividend” activities, where both countries boost their institutional and technical capabilities. Second, South-South cooperation enables developing countries to learn from the experience of other similar countries, sharing initiatives that are much closer and whose startup is cheaper than the technical assistance supplied by developed countries. Third, South-South cooperation tends to broaden the range of existing cooperation models and cultures,

creating a healthy competition climate for traditional donors. Fourth, the emergence of new donors expands the range of options for recipient countries, which helps them increase their room for strategic maneuver in the international scene (Kragelund 2008, Zimmermann and Smith, 2011). Finally, South-South cooperation contributes to disseminate a sense of common responsibility in tasks associated with the correction of international inequalities.

Based on all these attributes, it would be reasonable for traditional donors to support the efforts of some MICs to provide an efficient and technically solid South-South cooperation system, by supporting the institutions in charge of this policy. Through triangular cooperation, traditional donors can get involved by more actively supporting South-South cooperation, increasing available resources or facilitating projects that would not be feasible otherwise. Similarly, donors may back up cooperation initiatives within a regional scope between developing countries, providing mechanisms of monitoring, evaluation and mutual learning at that level. Finally, the stronger presence of non-DAC donors in the cooperation system should entail a review of the system’s governance structure, opting for those which are more inclusive and representative. Up to now, the two initiatives arising in this respect, the Development Cooperation Forum of ECOSOC, and the Global Partnership on Aid Effectiveness, arising from the post-Busan dynamics, are still imperfect attempts to reform the system’s governance, but they both signal this task is opportune.

#### **b) Support to Regional Integration Processes**

Since the origin of development theory, regional integration was considered to be a good way to overcome some of the issues arising in development processes. Through integration, mutual institutional capacities are enhanced, the market available to encourage industrialization is expanded, exchange between countries is promoted, and overall bargaining position of affected countries in the international system is improved. The views that inspired integration processes in the past, understanding the regional market as a space to encourage industrialization, has been replaced in recent times with a more open conception of regionalism, which emphasizes the role of the regional environment as a platform –for competitive and institutional strengthening– from which to encourage the external expansion of member economies.

In spite of its potential and the multiple initiatives launched, the truth is that a large part of regional integration experiences between Southern countries have not met the expectations with which they were initially created. The degree of success varies with each case, but very few integration schemes have followed a pattern of continuing progress. The causes of these meager results include the dependence on extra-regional economies (basically from the developed world), limited economic complementarity of partner countries, resistance to surrendering sovereignty that is entailed in any integration process, the limited effort made to create solid institutions linked to the integration process, or the limited reputation advantage derived from regional association. Despite this, regional integration is an option to be contemplated as a desirable alternative for a broad group of developing countries, regardless of whether those countries or the region altogether take part in other bi-regional or multilateral agreements.

Middle-income countries are expected to be prominent in regional integration schemes. This role results from the size and, in some cases, from the dynamism of countries, which generate major externalities over their regional environment. Some donors have found in such effects a reason to support their cooperation with certain MICs (sometimes referred to as “anchor countries”) (BMZ, 2011). By supporting a successful trajectory of progress in those countries acting as regional poles, donors may create the basis to open new development opportunities for the entire region. As Cohen (2006: 91) points out: “There is no better predictor of a country’s economic growth than the growth rate of its closest neighbors”. International development cooperation may take advantage of this role held by MICs to support regional integration processes.

Work in this field can be carried out in three major areas. First, by enhancing human and technical capabilities of the institutions in charge of integration; second, by promoting experiences of inter-government policy coordination within the region, in order to build a culture of trust and shared work among partners, even in areas not inherent to the integration process. Finally, of great interest are those initiatives aimed at improving the connection between countries, through investment on infrastructures, not only physical, aimed at promoting exchange and communication between partners, intensifying their relations and interdependences.

### **c) Provision of Regional and Global Public Goods**

As was previously pointed out, one of the tasks for international cooperation is to improve the levels of provision of regional and global public goods with an impact in terms of development. At the same time, we have seen that MICs have, due to their weight and dynamism, a relevant role in the provision of these goods at a global scale, and they are among the countries most affected in the event of their inadequate provision. For example, MICs are responsible for 54% of CO<sub>2</sub> emissions, with a growing trend in their share. Clearly, setting an agreement framework to limit emissions will not be an easy task without the effective consensus and involvement of these countries. Something similar occurs in relation to biodiversity, since 65% of global forest areas are located in middle-income countries: without their collaboration it will be difficult to preserve this world heritage.

Nonetheless, the provision of public goods entails some costs. A country with severely restricted resources (a developing country) is not likely to assume these costs on its own, knowing that the benefits of such action would be shared with countries with much higher incomes. The result will be a trend toward opportunistic behavior (free-rider). In order to correct this trend, the international community must create incentive mechanisms and support MICs to offset part of the costs which they incur, encouraging them to adopt a more committed role in the management of common issues.

Although a broad group of MICs are key in the provision of international public goods (IPGs), there are many countries within this group that would also be severely affected by the under-provision of such goods. The best example can be found in climate change: if the lack of an international solution is prolonged over time, a vast group of middle-income countries would be seriously affected by the consequences of the increasing temperatures (among them, several Pacific island and many countries in Central America and the Caribbean). Both the economic vulnerability index and the natural disasters risk index clearly evidence this reality. Specifically, from the 15 countries most exposed to natural disaster risks, 11 are middle-income countries; and from the 15 with the highest level of aggregate risk<sup>14</sup>, 13 are middle-income countries (Table 8).

**TABLE 8: 15 COUNTRIES WITH GREATEST EXPOSURE AND RISK OF NATURAL DISASTERS**

EXPOSURE TO NATURAL DISASTERS			INDEX OF RISK OF NATURAL DISASTERS		
COUNTRY	GROUP	INDEX	COUNTRY	GROUP	INDEX
Vanuatu	MIC	63.66	Vanuatu	MIC	36.31
Tonga	MIC	53.27	Tonga	MIC	28.62
Philippines	MIC	52.46	Philippines	MIC	27.98
Japan	HIC	45.91	Guatemala	MIC	20.75
Costa Rica	MIC	42.61	Bangladesh	LIC	20.22
Brunei	HIC	41.1	Solomon Is.	MIC	18.15
Mauritius	MIC	37.35	Costa Rica	MIC	17.38
Guatemala	MIC	36.3	Camboya	LIC	17.17
El Salvador	MIC	32.6	East Timor	MIC	17.13
Bangladesh	LIC	31.7	El Salvador	MIC	16.89
Chile	MIC	30.95	Brunei	HIC	15.92
Holland	HIC	30.57	Papua New Guinea	MIC	15.81
Solomon Is.	MIC	29.98	Mauritius	MIC	15.39
Fiji	MIC	27.71	Nicaragua	MIC	15.36
Cambodia	LIC	27.65	Fiji	MIC	13.69

Source: World Risk Report, 2012

This problem not only occurs in connection with environmental issues. Middle-income countries are among those most harmed by the lack of efficient mechanisms to provide international financial stability, as these countries are most exposed to the instability risks implied in these markets; middle-income countries may also be negatively affected by an inappropriate regulation of intellectual property rights, as these countries have the greatest demand of technology resources; ultimately, it is MICs which may be most affected by the inappropriate regulation of international migration, since they are the top contributors to migratory flows.

The prominence of MICs can be even greater in the provision of regional or sub-regional public goods: in these cases, the provision of goods will essentially depend on the countries involved, which in many regions are all developing countries. Some examples include the management of a river basin, the treatment of a “common good” (such as a forest area), the generation of instances for macroeconomic coordination, the outline of shared mechanisms for exchange risk attenuation or the setting of networks

and infrastructures for the correct use of an energy resource. In all cases we refer to regional public goods, which shall be provided only if those countries involved agree to it, economically contribute to it, and establish the necessary institutions to make such provision possible.

International development cooperation may exert a relevant role in these areas, by supporting agreements and contributing with financial and technical resources to make them possible. It may also support the institutions required for the management of some of these goods.

**d) Changing the rules and structures of global governance: toward policy coherence**

One last area in which to roll out the policy of development cooperation with MICs is that associated with the effect of other policies –beyond aid– on these countries’ chances for progress. For many middle-income countries, as was previously stated, the importance of aid is relatively minor; these are countries that are much more integrated in the international markets than poorer countries.

<sup>14</sup> Aggregate risk results from considering four aspects: exposure to risk, susceptibility of being affected, capacities to deal with risks, and adaptive possibilities.



Thus, the orientation of donor policies is crucial, due to their great influence on the development possibilities of countries. This is why one of the mandatory aspects of the policy of cooperation with MICs is the improvement of policy coherence levels. Nevertheless, in an increasingly global world, policy coherence is not a goal that may be defined at a merely national scale: it should also affect the regulatory frameworks within which international relations are managed.

These rules are particularly relevant for MICs, since they are still fragile economies, yet increasingly more exposed to the conditions of the international system. The existing rules with regard to trade, intellectual property rights and the regulation of foreign investment can be quite relevant for the development possibilities of these countries. In such cases the international environment should ensure the desired balance between preserving sufficient policy space for national strategies and, at the same time, provide global rules that are fair and efficient in order to regulate common issues. Some of the benefits that middle-income countries may obtain from international cooperation are derived from the modification of global rules that govern international transactions.

Together with the change in rules, it is also essential to adapt the governance instances of the international system in order to allow MICs, particularly the larger ones, to take part in the decision-making process at a global scale. Many of the existing institutions are, with slight modifications, those created in the 1950s, but the current world is so much different than the one which existed seven decades ago. It is important

to make progress in the reform process, not only of informal inter-governmental instances –like the transit of G-7 to G-20–, but also of more central multilateral organizations in the global governance (such as the IMF, the Security Council, or the Bank for International Settlements, among others). In these cases the role of development cooperation is limited, but there is room for political dialogue and for the creation of alliances within the international instances to which donor countries belong.

### 5.3. SUMMARY: A SYSTEM TO MAXIMIZE DEVELOPMENT INCENTIVES

The agenda proposed for MICs is intended to be consistent with the need to turn development cooperation into a system that maximizes development incentives. To this end, work must be deployed along four complementary lines of action: i) supporting countries to overcome deficiencies and structural bottlenecks in their development processes (promote national improvements); ii) ensuring the achievements attained given potential risks of reversal (avoid reversals); iii) maximizing the indirect benefits obtained by some countries as a result of the progress of other countries (benefit from positive externalities); and iv) building a cooperative action to deal with common problems (promote cooperative effort). In all of these aspects the development cooperation has an important role to fulfill in middle-income countries (Table 9): the described agenda integrates these aspects to a large extent within a coherent framework.

**TABLE 9: TASKS OF AN INCENTIVE-COMPATIBLE DEVELOPMENT SYSTEM**

General Goal	Specific Goals	Cooperation with Middle-Income Countries
Incentive system to maximize development efforts	Promote Improvements	Overcoming structural deficiencies (middle-income traps)
	Avoid Reversals	Fighting poverty (and help correct inequality) Reducing risks and vulnerability
	Benefit from Externalities	Changing the rules and structures of global governance
	Promote Cooperative Effort at a global scale	Support dynamic regional poles of growth and favor integration
		Provide regional and global public goods Support South-South Cooperation

## 6. INSTRUMENTS AND ACTORS OF COOPERATION WITH MIDDLE-INCOME COUNTRIES



In previous sections it has been argued that, even when needing international support, the development agenda for middle-income countries is very different from that of poorer countries. Likewise, aid implementation in MICs has unique profiles which must be considered, and which affect the roles of various actors.

### 6.1. THE INSTRUMENTS

As often occurs when defining an agenda, the most appropriate implementation of aid is highly dependent on the specific traits of a given MIC. It is very likely that in the case of the least developed countries within this group, the most suitable implementation is not so different from what is commonly used for LICs; and, conversely, in countries with higher development, instruments not necessarily reported as ODA will probably have a much broader space. The typical heterogeneity of the middle-income group justifies this diversity. In any case, there is a vast group of countries between the above-mentioned extremes, for which the implementation of development cooperation may acquire specific profiles. The following considerations are formulated with regard to this sub-group.

It is important to emphasize an idea mentioned before: development problems suffered by a great deal of MICs are not so much related with the provision of external resources, but with overcoming specific restrictions related to their governance conditions, social cohesion, productive change and international integration in said countries. Based on this, there are three precautions worth noting.

First, cooperation with these countries should be, in most cases, highly selective and strategic. It is not about designing generic supports for every country, but rather about identifying for each case the location of bottlenecks, and the core problems which block the path of progress. Cooperation planning should be adapted to the selective nature of aid, being more demanding and strategic in identifying priorities, and more flexible in adapting to the country's change process. It should therefore be a much more dynamic, less heavy and comprehensive than the one advised, for instance, by the Poverty Reduction Strategy Papers.

Second, it has been noted that middle-income countries are quite heterogeneous, as seen in the productive, social and regional sectors. This fact may suggest the adoption of sub-national perspectives at the time of designing cooperation actions. International aid can help through this perspective to compensate, although partially, the existing regional inequalities, going where deficiencies are greater.

Last, in many cases –particularly in larger or more developed countries– aid will always be a minor part of the international funding they receive. For this reason, the most relevant role aid has there is to modify the incentive framework in which agents operate, and not the effects derived from the



direct funding of changes. Thus also suggests that, together with aid, other cooperation instruments not reportable as ODA can be extraordinarily relevant.

In sum, the planning of interventions in MICs should be highly specific. It requires a very demanding previous diagnostic effort and dialogue with the recipient country, the strategic ability to selectively determine actions, specialized technical capacity, and a broad (and fresh) view to identify the most suitable actors and instruments (sometimes, beyond those strictly reportable as ODA).

This approach to aid determines the type of implementation required for each case. In this regard, and recognizing the difficulties entailed by any generalization, there are five aspects worth emphasizing in terms of aid implementation in MICs.

- First, in the aid system it is generally important for donors to give increasing relevance to programme-based approaches, as these allow recipients to anticipate the committed supports and grant more predictability to flows. Studies on aid effectiveness are remarkably conclusive in this regard: the variability of flows, the inability of recipients to predict them, is eventually detrimental to aid effectiveness. Therefore, following such program-based aid approaches seems to be a mandatory recommendation, regardless of the country in question.
- Second, as a general rule, those instruments which are either highly intensive in the channeling of financial resources (e.g.: budgetary support), or are highly intrusive to the recipient's decision-making process (e.g.: sector-wide support) are less adapted to the conditions of cooperation with MICs. Nonetheless, these instruments can be relevant in some countries (particularly those with lower incomes within the group) and for some sectors (for example, support to secondary education). But, in general, these instruments are more appropriate for cooperation with LICs. In the case of middle-income ones, the inadequacy of these instruments is based on two additional factors. First, the weight of aid in the total public budget is low, so –with a few exceptions– there are no stimuli for governments to subject themselves to such demanding formulas as those required

by these mechanisms (budgetary support or sector-wide approach) in order to receive resources. Second, governments have sufficient technical and institutional capacities of their own in order to claim greater autonomy in the design of their policies, with no need to subject them to donor scrutiny. In sum, more selective instruments than those commented above seem to be more appropriate for middle-income countries.

- Third, in cooperation with MICs, technical cooperation plays a crucial role. A great deal of donor efforts is aimed at strengthening institutions, transferring capacities and improving the design and implementation of policies. The predominant way for channeling aid in these cases is through technical cooperation. However, this type of cooperation has raised much criticism, as it is often based on an aid offer that is induced and determined by the donor, with excessive weight of expatriate experts and without questioning the applicability of the knowledge and the experiences being transferred to the local context. This criticism is true, as it alludes to the typical deficiencies of technical cooperation (Alonso, 2001). Overcoming such constraints is particularly relevant in the case of MICs, where we can move more easily toward technical cooperation based on local competences and institutions, more focused on deploying the country's own capacities than on the mere transplant of donor capacities. Their great number of highly competent professionals, the more reduced and precise nature of their requirements and the presence of other countries with similar issues and successful experiences within their regional environment make this task easier.
- Fourth, some cooperation action in MICs is applied in areas where ODA is not as important as other cooperation instruments that go beyond aid. Work in the fields of enterprise promotion, investment on infrastructures, support to innovation and technological capacities or business financing, requires instruments which are only partly reportable as ODA. This is the case, for example, with financial cooperation (loans, insurance and equity participations),

the promotion of public-private associations to combine resources and capacities, or horizontal agreements between research centers and universities, which do not necessarily entail the mobilization of resources reportable as ODA. In the case of middle-income countries it is possible to establish much more horizontal cooperation relationships, where actors on both sides are genuinely interested, and such interest is not derived from the funds mobilized by the donor. Managers of cooperation with MICs should pay special attention to the possibilities provided by those instruments.

- Finally, financial instruments are of special interest to support the private sector of developing countries. Donors have created specialized institutions, the Development Financial Institutions (DFI), to manage these instruments. Some of the resources channeled by these institutions are not reportable as ODA, but they can prove really useful as support mechanisms for enterprise and innovation initiatives in recipient countries, with an impact in terms of development. To achieve this result, the instrument must be flexible and with the ability to identify opportunities and assume risks. It is in MICs where this type of instruments can have greater potentiality. In the Spanish case, the design of this instrument is not entirely appropriate, as it presents inconveniences which affect both its operations and management structure, which can seriously restrict their effectiveness. If Spain seeks to deploy a more dynamic action in this field, their design and regulations should be reviewed.

### **6.3. THE ACTORS**

As in other cases, in cooperation with middle-income countries there is space for the participation of a broad variety of social actors: and all of them should be involved in the policy being designed. However, compared to the cooperation with poorer countries, middle-income ones present three traits worth emphasizing:

- First, as was previously pointed out, MICs are characterized by a deep social and regional fragmentation, expressed in the

form of high levels of inequality. Under such conditions, public institutions are likely to be inefficient in the correction of social exclusion and marginalization, as they are run by the prevailing interests. For this reason it is essential to work with civil society organizations, to strengthen the demands for social cohesion and to exert pressure in order to improve the quality of institutions. The role played by NGOs in promoting such objectives through advocacy tasks is crucial. At the same time, NGOs may play a key role in the access to public decisions by the more marginal sectors and to launch targeted initiatives to reduce exclusion. Social policies in middle-income countries are still fragile and, although their coverage intends to be universal, they usually exclude certain sectors of society. NGOs should also operate within the gaps of said policies, in order to enhance their universality and prevent any exclusion they could produce. In this case, paraphrasing Collier and Dollar (2004), it would not be enough for cooperation to work with the government, as it may be necessary to work through the government, by involving it in activities considered desirable, and work around the government, supporting the social dynamics which exert pressure on the government so that the latter increases its commitment in the combat of exclusion and poverty. In these two latter tasks, NGOs may have a key role.

- Second, cooperation with MICs requires a more active presence of actors not necessarily specializing in cooperation work. Such is the case of research centers, business incubators, universities, institutions linked to the private sector, or institutions specializing in services to companies. The multiplicity of actors should be much higher in this case, to a large degree because the role of traditional actors (public agencies and NGOs) is much less relevant than in poorer countries. Relationships based on knowledge and trust which are needed to involve such actors (beyond traditional agents of the cooperation system) do not always exist in development interventions in middle-income countries. Nevertheless, it is those actors who own the specialized knowledge that MICs usually require, and this is why their involvement is so crucial. Cooperation managers should

bear this in mind, opening the focus of their work alliances to integrate this multiplicity of actors.

- Finally, although public development agencies also play a fundamental role in cooperation with middle-income countries, their function should not be to lead the interventions, but rather to enable the necessary alliances between actors in order to make such interventions effective. As stated in the previous item, cooperation with MICs should summon multiple specialized institutions which are not typically part of the cooperation system. The relationship between this type of actors from the donor and recipient countries is very likely to be established in a much more horizontal environment, of collaboration between equals, thus breaking the vertical logic of traditional cooperation. This trend is promoted because many of the major challenges of MICs (environment, unemployment, innovative enterprise, institutional strengthening, etc.) are problems which must also be addressed

by developed countries. Therefore, there are better conditions to move from aid to cooperation (the latter understood by its literal sense of “common work”). From this perspective, the role of the official agency would not be to lead interventions, but rather to create the conditions so that actors become involved and lay down the networks of agreement and common work in order to make changes a reality. Thus, a development agency would act more as a mediator than as a provider of services. Its role would be to record the recipient’s needs, identify suitable actors to meet such needs, through a dialogue with all of them, creating the right conditions to establish a network of shared work and defining the incentives (including financial incentives) to make this coordinated action feasible. The competences required for this type of institution are very different from traditional ones a development agency has had in the past: its work focus consists of policy dialogue, relationships with actors and the definition of incentives, instead of funding or direct service provision.

## 7. FINAL CONSIDERATIONS

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In previous sections we have attempted to set out the reasons why donors should keep an active policy of cooperation with MICs; at the same time, we have discussed the specificities that this policy should have, both in terms of agenda and implementation. This section does not intend to repeat the arguments previously offered, but rather to summarize the main ideas expressed here:

- First, the international scene has changed rather dramatically over the last years. This forces us to rethink the design and contents of the development cooperation system we want for the future. A great deal of those changes are led by MICs which, in turn, comprise the bulk of the population (and poverty) of the developing world. This process is not likely to be modified in the immediate future. For that reason, it seems necessary for donors to review their position with regard to middle-income countries in order to address their deficiencies and involve them more actively in the management of collective issues.
- Second, given the limited resources available, international cooperation should adopt an incentive-based approach, to obtain maximum development impact in the international system. As well as performing its typical redistribution role, it must also consider aid's ability to generate dynamic incentives for change in those countries in which it operates. This means that cooperation must encourage development efforts by all countries, prevent reversal risks, make use of the positive externalities which countries have on others, and promote international cooperative action.
- Third, considering the two factors above, we can confirm the need to maintain cooperation with MICs, in order to create an incentive system compatible with development objectives. This entails reviewing the criteria for country eligibility and graduation, generating transition processes which remove the costs which the simultaneous withdrawal of aid can cause to affected countries.
- Fourth, the agenda for cooperation with MICs should be based on two major purposes: to help countries overcome the middle-income traps (associated with governance and social fragmentation issues, financial integration of countries and productive change & technological processes), and to support their involvement in cooperative action at a global scale (enhancing their integration processes, their policies for cooperation with other Southern countries, their involvement in the provision of international public goods and their greater visibility in the definition of global rules and governance).
- Fifth, in the implementation of cooperation with middle-income countries, the more intrusive forms of aid have less relevance, being replaced by technical cooperation and by those instruments operating beyond aid, in the fields of funding, generation of alliances and establishing horizontal relationships between countries.
- Sixth, multiple actors, many of whom are specialists not typically involved in the aid system, are summoned to work in the cooperation with MICs. Such diversity of actors implies searching for less vertical and hierarchical work relations, to the benefit of more horizontal, network relations; at the same time, the official development agency should move from being a provider of

services and funding to become a mediator, capable of identifying actors, building alliances and generating the incentives required for common work.

- Finally, cooperation with MICs, understood as suggested in these pages, to a certain extent anticipates what tomorrow's cooperation should be like, as envisioned in the Busan agreement. That is, a more complex cooperation, capable of attracting multiple actors, including instruments

beyond aid, establishing more horizontal and cooperative work relationships, and working on the basis of an agenda which includes the fight against extreme poverty, but also integrates other aspects inherent to development. For this reason, to a certain extent, cooperation with middle-income countries is a good laboratory for what could become the future of development cooperation for the world that emerges after the crisis.

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## APPENDIX:

# MIDDLE INCOME COUNTRIES: AREAS OF WORK, STRATEGIC FIELDS, ROLE OF COOPERATION AND MAIN INSTRUMENTS



MIDDLE INCOME TRAP	PROBLEMS	STRATEGIC AREAS	POTENTIAL INFLUENCE OF INTERNATIONAL COOPERATION	MOST RELEVANT INSTRUMENTS	
Help to overcome middle income traps	Governance Trap: strengthening institutions and improving social cohesion	Exclusion and Social fragmentation (inequality)	Support to social policies with basic universal standards in education, health and social protection.	High	BS; SS; P&P; TA; RC; PD
			Support to active policies for the inclusion of marginalized groups	High	P&P; TA; PD
			Support to education (mainly secondary and vocational) as a mechanism of social mobility	High	SS; P&P; RC; PD
			Support to policies of regional rebalancing and decentralization	Medium	P&P; TA; RC; PD
			Support to policies of gender equality promotion	High	P&P; TA; PD
		Institutional	Support to technical capacities of institutions for the design of public policies	Medium	TA; PD
			Support to the creation of a body of civil servants (public administration)	Medium	P&P; TA; PD
			Support to Governments' transparency and accountability	Medium	P&P; TA

**Note:** The list of most relevant instruments is purely indicative: in each case, an analysis of the precise conditions of the intervention is required. The acronyms used correspond to the following instruments: BS: budgetary support; SS: broad sector strategies; P&P: projects and programs; TA: technical assistance; RC: reimbursable cooperation; PD: political dialogue. Finally, it is assumed that advocacy or development service provision work carried out by NGOs are to be implemented preferably through projects and programs.

MIDDLE INCOME TRAP	PROBLEMS	STRATEGIC AREAS	POTENTIAL INFLUENCE OF INTERNATIONAL COOPERATION	MOST RELEVANT INSTRUMENTS
Help to overcome middle income traps	Institutional	Support to mechanisms for dialogue and social consensus.	Medium	P&P; TA
		Support to the fight against corruption	Low	P&P; TA; PD
	Fragile fiscal contract	Support for the design of a capable, efficient and equitable tax system	Medium	P&P; TA; PD
		Support to tax authorities (including Customs)	Medium	P&P; TA
		Support to measures against tax avoidance and evasion	Low	P&P; TA; PD
		Advances in international tax cooperation	Low	PD
		Fight against illicit financial flows	Low	TA; PD
	Excessive need for financing in foreign currency	Support to policies for the promotion of domestic savings	Low	TA; PD
		Support to non-recessive macroeconomic stability	Low	TA; PD
		Support to local financial systems	Low	TA; RC; PD
		Financial regulation on a global scale	Low	PD
	Limited fiscal space	Regulation of capital accounts	Low	TA; PD
		Financial cooperation on a regional scale	Low	TA; RC; PD

MIDDLE INCOME TRAP	PROBLEMS	STRATEGIC AREAS	POTENTIAL INFLUENCE OF INTERNATIONAL COOPERATION	MOST RELEVANT INSTRUMENTS	
Help to overcome middle income traps	Productive Change Trap: improving technological capacities and productivity	Cooperación en el ámbito científico y tecnológico	Medium	PyP; AT; DP	
		Dificultades para transitar desde la copia y adaptación tecnológica a la innovación	Apoyo a los servicios de promoción de empresas innovadoras (incubadoras de empresas innovadoras, spin-offs corporativas y universitarias)	Medium	PyP; AT
			Apoyo a la capacitación empresarial	Medium	PyP; AT
		Difficulties in moving from technological copy/ adaptation to innovation	Cooperation in science and technology	Medium	P&P; TA; PD
			Support promotion of innovative companies (innovative company incubators, corporate and university spin-offs)	Medium	P&P; TA
			Support to business training	Medium	P&P; TA
		Difficulties in production diversification and moving toward sectors with higher added value	Support to financing entrepreneurial initiatives (seed capital and venture risk)	High	TA; RC
			Support to improvements in the regulatory framework to promote the dynamics of business demography	Medium	TA; PD
		Difficulties to impose environmentally sustainable energetic and technological patterns	Support to the implementation of renewable and less pollutant sources of energy	Low	TA; RC
			Support to the design of sustainable development strategies	Medium	TA; PD
		Limited or inefficient integration of existing human capital	Support to high-quality secondary education	High	BS; SS; P&P; TA; PD
			Support to professional and vocational training	High	BS; SS; P&P; TA; PD

	MIDDLE INCOME TRAP	PROBLEMS	STRATEGIC AREAS	POTENTIAL INFLUENCE OF INTERNATIONAL COOPERATION	MOST RELEVANT INSTRUMENTS
Support to international cooperative action	Support to South-South and triangular cooperation	Technical and institutional weakness of new donors	Technical and institutional enhancement of organizations in charge of South-South cooperation policies	High	P&P; TA; PD
		Limitation in levels of priority and resources for this policy	Support to triangular cooperation	High	P&P; TA; RC
		Inappropriate international framework in cooperation system governance	Review rules and structures of development cooperation system governance	High	PD
	Support to regional integration processes	Limited institutional structure for the integration process	Support to institutional instances for the regional integration process	Medium	P&P; TA; PD
		Limited entity for regional-scope policies	Support to regional policies	High	SS; P&P; TA; RC; PD
		Limited experience of interaction and shared work culture	Support to inter-government processes of work and investment in infrastructures for regional connectivity	Medium	P&P; TA; RC; PD
			Support to investments in infrastructures for regional connectivity	Medium	P&P; RC; PD
	Support to the provision of regional and global public goods	Limited provision of regional public goods	Support to the provision of regional public goods	Medium	PyP; CR; AT; DP
		Limited involvement in the provision of global public goods	Support to actions aimed at improving involvement in the provision of global public goods	Medium	CR; AT; DP
			Support to supplementary actions for the adaptation of international measures related to international public goods	High	PyP, AT, CR, DP
	Support to change of governance rules and structures	Rules with asymmetrical results in the distribution of development opportunities	Support to the change of international rules, particularly those which restrict the countries' room for policies	Low	PD
		Non-inclusive global governance structures	Promotion of more inclusive governance structures	Low	PD





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