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The role of aid to middle-income countries: a contribution to evolving EU development policy

Jonathan Glennie

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Acronyms

MIC	Middle-Income Countries
EU	European Union
EC	European Commission
UN	United Nations
LDC	Least Developed Countries
LIC	Lower-Income Countries
LMICs	Lower-Middle-Income Countries
MDG	Millennium Development Goals
GNI	Gross National Income
DFID	Department for International Development
UMIC	Under-Middle-Income Countries
EDF	European Development Fund
OECD	Organisation for Economic Co-operation and Development
HIC	High-Income Countries
PPP	Purchasing Power Parity
AGOA	African Growth and Opportunity Act
ODA	Official Development Assistance
GDP	Gross Domestic Product

Abstract

With a Green Paper process on EU development cooperation and the debate on the Financial Perspectives both underway, this is an important time to review aid to middle-income countries (MICs). This paper seeks to provide evidence and ideas to help aid allocation decisions for the EC institutions and EU member states. It is ordered as follows:

- first, introduces the topic in the context of evolving EU development policy
- second, reviews definitions and membership of income-related country groupings
- third, describes the evolution of aid flows to country groups
- fourth, assembles the arguments for and against aid to middle-income countries
- fifth, concludes with two broad recommendations on how to conceptualise aid to MICs for its effective use in achieving development results.

The main conclusion of the present analysis of current evidence, thinking and practice is that international support to MICs, including financial aid, continues to play an important role in global development. Aid plays two roles in MICs: as a non-essential catalyst for change and, in some cases, as part of an orderly graduation process from aid dependence.

1. Introduction

How much aid should be provided to middle-income countries (MICs)? And what should it be spent on? These are among the most debated issues in development cooperation, particularly in the European Union (EU). Some argue that aid should be concentrated on poverty reduction in the poorest countries. Although poverty exists in MICs, they are themselves rich enough, this group would argue, to find the resources to respond to it. As donor budgets are squeezed, scarce resources must be allocated where they are most needed. But there are others who argue that providing aid to MICs is both legitimate and necessary: first, if the Millennium Development Goals are to be met; and, second, if the eradication of absolute poverty is not the only purpose of aid.

Internationally, the debate has been brought to the fore by a financial crisis affecting most donor countries and forcing them to reassess the size of aid budgets, and by the growing wealth of the larger MICs, like China and India. A series of UN conferences on MICs, hosted by Spain and El Salvador in 2007 and Namibia in 2008, analysed common priorities, and looked at how the international community could best support progress. Aid emerged as one part of the answer.

The EU's 2006 European Consensus on Development addresses the topic of aid to middle-income countries, making it clear that the least developed countries (LDCs) and other low-income countries (LICs) will be the priority for EU aid, especially if they are in Africa, and that the lower middle-income countries (LMICs) should be the focus of assistance to MICs.

> 'Development policy must reflect a distribution of resources which takes account of the effect of such resources on poverty reduction. Consequently, particular attention must be paid to the situation of the LDCs and other LICs, as part of an approach which also encompasses the efforts by the government of the partner countries to reduce poverty as well as their performance and absorption capacity. The LDCs and LICs will be given priority in terms of overall resource allocations. The Community should find ways to increase the focus on the poorest countries with a specific focus on Africa.'[1]

The Development Consensus does however recognise the importance of continuing to support development and poverty reduction in middle-income countries:

> 'Support to middle-income countries also remains important to attaining the MDGs. Many lower MICs are facing the same kind of difficulties as LICs. A large number of the world's poor live in these countries and many are confronted with striking inequalities and weak governance, which threaten the sustainability of their own development process. The Community therefore continues to provide development assistance based on countries' poverty reduction or equivalent strategies. Many MICs have an important role in political, security and trade issues, producing and protecting global public goods and acting as regional anchors. But they are also vulnerable to internal and external shocks, or are recovering, or suffering, from conflicts.'[2]

In reality, European Community (EC) aid appears to retain the ambition of almost universal coverage. In 2007 it was present in over 145 developing countries. In 2007, 44% of EC aid was allocated to LICs, well below the DAC average for all donors of 63% and the average for EU member states of 65%. In 2008, EC aid to LICs fell to 42% and in 2009 to around 34%. The 2007 OECD DAC Peer Review of EC Aid identifies this as a problem.[3]

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[1] EU (2006: para. 66).
[2] Ibid. (para. 61).
[3] See http://www.oecd.org/document/0/0,3343,en_2649_34603_38897408_1_1_1_1,00.html

The DAC points out that the EU attaches particular importance to its neighbouring countries, particularly in the context of their prospective membership of the EU. Turkey's status as the top recipient of EC aid is a case in point (see Annex 3). In such a context it is not clear whether repeated commitments to focus EC aid on LICs are actually being implemented. One of the questions this paper asks is whether such commitments are still appropriate.

Among EU members, different perspectives apply. The UK, for example, has a record of focusing its aid on low-income countries. Spain, on the other hand, has long favoured aid to Latin America, a middle-income continent. Other Southern European countries privilege Mediterranean countries, while Eastern European member states have a bias in favour of Eastern Europe and the former Soviet Union, which tend to be MICs.

2. Definition and membership of income-related country groupings

2.1 Overall classification

The most commonly used classification of countries by income per capita is managed by the World Bank and divides them into low-, lower-middle, upper-middle or high-income. As of April 2011 the range of gross national income (GNI) per capita, which rises over time with inflation, is as follows:

Table 1: World Bank definition of income categories[4]

	Middle-income countries (MIC)		
Low-income (LIC)	Lower-middle-income (LMIC)	Upper-middle-income (UMIC)	High-income (HIC)
$995 or less	$996 - $3,945	$3,946 - $12,195	$12,196 or more

The rationale for these bandwidths is not available and seems fairly arbitrary. The MIC band (which covers LMIC and UMIC) is particularly broad, with those at the top of the band over 12 times as wealthy (in GNI per capita terms) as those at the bottom. The classification's primary practical use is to define eligibility for concessional lending from the World Bank and similar development banks, but it is used by many donors to help assess how 'poverty focused' their aid programme is. In a recent DFID review of multilateral aid, for example, the European Development Fund (EDF) scored well because of its focus on LICs. Aid from the EU budget, on the other hand, scored badly because of its focus on MICs.

2.2 The LDC category

The OECD, which is the most important body analysing aid statistics, uses a slightly different method to categorise countries by income per capita. While based on the World Bank's model it only covers countries that are recipients of OECD aid and therefore does not have a HIC category. While the World Bank reclassifies countries every year as new data comes in, the OECD does so every few years, so the bands do not alter as frequently. Countries graduate from the aid recipient list if they reach high income status and remain there for a few years.[5]

Crucially, the OECD also incorporates the concept of Least Developed Countries (LDCs). Countries are formally defined as 'least developed' by criteria which take into account human development indicators and economic vulnerability, as well as income per capita. Large economies are excluded by a limit on population size of 75 million. Countries can choose whether to be classified as LDC or not. Becoming a LDC means entering into a UN process with significant benefits, such as preferential trade access. Only 12 LICs are not also classified as LDCs.

Because the LDC classification is based on a more nuanced assessment of a country's predicament than solely per capita income, a number of MICs are LDCs. As of April 2011, there are 14 LDCs that are MICs.6 These countries are likely to be shielded from potential falls in aid as long as they remain within the LDC category.

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[4] World Bank (http://data.worldbank.org/about/country-classifications/country-and-lending-groups).
[5] Four countries are set for graduation in 2011: Antigua & Barbuda; Barbados; Oman; and Trinidad & Tobago
[6] The 14 LDCs that are now MICs are Angola, Djibouti, Equatorial Guinea, Lesotho, Sao Tomé and Principe, Senegal, Sudan, Yemen, Bhutan, Kiribati, Samoa, Timor-Leste, Tuvalu, Vanuatu.

The introduction of the LDC category is one reason for discrepancies between World Bank and OECD country classifications. Another is the time delay caused by the fact that the OECD does not reclassify every year.7 Also, the OECD simply does not list the countries, including a number of MICs (mostly UMICs such as Romania and Russia), which do not receive OECD aid.

2.3 Relating average country income to levels of poverty

Caution must be applied when relating country-income classification to the international poverty lines of $1.25 or $2 a day. While the country classification uses current US dollars (the Atlas method), personal poverty lines use purchasing power parity (PPP) or 'international dollars'.[8]

India's GNI per capita in 2009 (using the Atlas method) was $1180, for example, meaning that daily per capita income (if India were totally equal) would be $3.23. But using the PPP method, the PPP GNI per capita in the same year was $3250, or $8.90 per person per day. Mali's GNI per capita (Atlas) was just $680 in 2009, making it a LIC. But with a GNI per capita (PPP) of $1190, Mali could theoretically ensure that each citizen had $3.26 (PPP) per day.

It is recognised that average income measures are very limited assessments of poverty, which is why more complex analyses have been developed, including the Human Development Index and, more recently, the multidimensional poverty index. Having said that, there is a clear relationship between higher income per capita and higher human development indicators. Life expectancy, institutional quality, technological advance, percentage of the population living in poverty – all are indicators which tend to improve as income per capita increases. The only exceptions to this general rule are inequality and higher education, where there is no clear statistical difference between LIC and MIC status.[9] Most of these differences are also discernable when comparing LMICs to UMICs, but to a lesser degree.

2.4 The changing geography of poverty

Recent analysis has demonstrated a significant shift in the geography of poverty over the last ten years, namely a dramatic reduction in the number of LICs. Since 2000, 26 LICs have graduated to MIC status (see Table 2), with Ghana now also teetering on the boundary.

Table 2: Years of graduation from LIC to MIC since 2000

Year	Countries
2000	Turkmenistan
2001	-
2002	Armenia; Ukraine
2003	Azerbaijan; Georgia; Indonesia
2004	Angola
2005	Cameroon; Congo, Rep.; Lesotho; Moldova; Nicaragua
2006	Bhutan
2007	India; Sudan; Mongolia; Timor-Leste
2008	Côte d'Ivoire ; Nigeria; Pakistan; Sao Tomé and Principe; Solomon Islands*
2009**	Senegal; Uzbekistan; Vietnam; Yemen

* Relapsed to LIC status in 2009

** Tuvalu was classified as a MIC in 2009, but as it had not been classified previously, it is not 'graduating'

A look at the OECD categories since 1999 (Table 3 below) tells a similar story, but there is less movement as the LDCs do not shift status based on rising income per capita alone.

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[7] 6 LICs have become MICs since the OECD's most recent classification in 2007: Cote d'Ivoire, Nigeria, Pakistan, Papua New Guinea, Vietnam, Uzbekistan.

[8] Kanbur (2010) appears to confuse these.

[9] Alonso et al. (2007: p32).

Table 3: OECD categories

	Least developed	Other low-income	Middle-income countries Lower-middle-income	Upper-middle-income
Income range (unchanged since 2007)	Not defined by income alone	$935 or less	$936 - $3,705	$3,706 - $11,455
1999	48	24	49	24
2009	48	12	45	39

Not including territories or non-recipients of DAC aid. The OECD DAC list was last updated in August 2009.[10]

This change means that there are now 104 MICs (as defined by the World Bank) which are home to 71% of the world's population. But the most startling statistics concern the location of the world's poorest people. While in 1990 94.4% of those living on under $1 a day, over 1.5 billion people, lived in LICs, by 2008 that number had reduced to just 23.3% (284 million). Correspondingly the proportion of poor people living in MICs has risen from 5.6% (94 million people) to 76.7% (933 million).[11]

While this large statistical shift is certainly important, there are two important caveats. First, the swing is almost entirely due to the graduation from LIC to MIC status of five very large countries. Second, there has been a high level of regression from MIC status in the past, implying that optimism about recent economic growth should be balanced by caution.

2.5 The rise of the PICNIs

The largest countries to graduate from LIC to MIC status since 1999 are China (which graduated to MIC status in 1999), Indonesia (re-graduated in 2003), and India (2007), Nigeria (2008) and Pakistan (2008) see Annex 2. The combined population of the five 'PICNI'[12] countries is about 3 billion people and they are home to about 70% of the world's poorest people. Clearly, they have been the major factor in the statistical shift. In fact, when we remove the PICNIs from the equation, there has been hardly any change in the percentage of poor people living in MICs since 1990 (see Figure 1, below).

This implies that rather than talking of a global phenomenon whereby the poor now live in MICs, it may be more appropriate to limit the implications of this shift to the five countries concerned. Importantly, despite there being more non-PICNI MICs than in 1990 (99 as opposed to 80), the number of poor people living in them has declined marginally, implying that poverty rates have fallen. Conversely, despite there being eight fewer non-PICNI LICs than in 1990, the number of poor people living in LICs has stayed the same, demonstrating a negative trend, explained in part by population growth.

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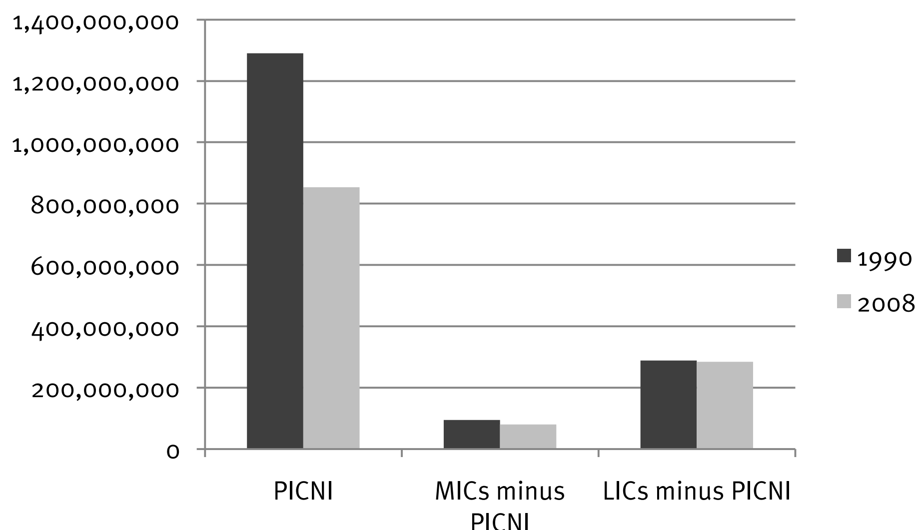
[10] See http://www.oecd.org/dataoecd/32/40/43540882.pdf. Since 2005 the OECD/DAC has stopped separating countries into Part I and Part II, and therefore no longer separates aid into Official Aid (OA) and Official Development Aid (ODA). All aid is now called ODA.

[11] Previous estimates have put the figure at 41% as recently as 2007, UN (2007a).

[12] I believe that Andy Sumner invented this acronym.

Figure 1: The poor now live in MICs, almost entirely because of PICNI graduation



Source: Author's calculations using World Development Indicators and Sumner 2010. Note that Sumner is presently revising these numbers, but the ball park figures will be similar.

2.6 A history of regression as well as progress

While the graduation of 26 countries to MIC status is cause for optimism, our assessment should be cautious. Between 1978 and 2003 25 countries fell back from MIC to LIC status. Some countries found themselves swapping LIC for MIC status every few years.

Table 4: Countries in each income bracket, by year[13]

	1978	1990	2003	2011
LIC	27	48	61	40
LMIC	54	50	56	56
UMIC	40	35	37	48
HIC	30	44	54	69
World	151	177	208	213
Total MIC	94	85	93	104
LDC	30	43	50	48

- Georgia, for example, was classified as a LMIC in 1991, became a LIC in 1993, rose to LMIC again in 1996, LIC in 1999, and has now been a LMIC since 2003.
- Indonesia became a LMIC in 1993 and remained one until the East Asian crisis of 1998 dragged it down to LIC status. It took five years for it to recover to LMIC status in 2003.
- In Honduras, 1990 was the year of regression to LIC status, from which it emerged again to LMIC status in 1998.
- Yemen regressed from LMIC to LIC in 1991 and only regained LMIC status in 2009.
- In Africa, Cameroon had been a LMIC for some years until 1994, when it fell back to LIC status. Only recently, in 2005, did it regain MIC status.

[13] World Bank (http://data.worldbank.org/about/country-classifications/country-and-lending-groups). This table (excluding the LDCs numbers) includes a few entities which are not countries but are separate economies, such as the Channel Islands (UK) and Macao (China). The significant increase in LICs between 1978 and 2003 can be partially explained by the increase in the number of countries (and territories) from 151 to 208. In that time 10 UMICs became HICs and 1 LMIC (South Korea) became a HIC. But only 1 LIC became a MIC and stayed there (Sri Lanka).

- Other African countries like Congo, Rep., Cote d'Ivoire and Senegal have similar stories, while Zimbabwe is yet to re-emerge as a LMIC, a status it held until 1991.

In fact, of the 26 countries that graduated from LIC to MIC status in the last decade, 18 had already been MICs in the past but had relapsed to LIC status, mostly in the early 1990s.[14]

Unlike the LIC/MIC classification, which has seen much movement between camps, the LDC group is very stable. 27 countries have been added to the original 1971 list of 25 LDCS, and four have left the classification[15], meaning that today there are 48 LDCs. According to UNCTAD, likely graduates in the near future are Equatorial Guinea, Samoa, Tuvalu and Vanuatu.[16]

It is possible that we have entered an era where falling back from MIC to LIC status is less likely than previously, and it may be crucial to note that of the PICNIs only China and Indonesia had been MICs before their most recent graduation. Chandy and Gertz (2011) predict a very optimistic future in which only 10% of the world's population will be poor by 2015, of which 55% will live in MICs, a significant fall from 75%, but still the majority.

But that will depend on a range of factors, listed by Kanbur and Sumner (2011) as, 'growth projections for individual countries; assumptions on exchange rate evolution; assumptions on international inflation and other aspects of the Atlas methodology for classifying countries as LICs or MICs; the evolution of income distribution within each country; any re-evaluation of PPPs in each country (and influence on $1.25 poverty) and population growth in individual countries.'

There is still uncertainty about how things will pan out, especially as climate concerns affect access to resources. In this context it is sensible for international support strategies to be long term and not to depend too heavily on a country's income status. The OECD's delay on changing a country's classification and use of the LDC category is probably a sensible caution in this regard.

In this section I have argued that while the number of MICs has risen significantly in the past decade, members of the category are vulnerable to falling back. The 'optimistic' story about a global graduation to MIC status, while important, is mostly driven by the transition experience of five countries: China, India, Indonesia, Nigeria and Pakistan. The MICs contain many more poor people than the LICs, but the numbers of poor people living in the present LICs has risen in the last two decades.

2.7 Trends in aid to MICs

For some years there has been pressure on donors, particularly the EC institutions, to increase the proportion of aid going to LDCs and LICs by reducing aid to MICs. So what has actually happened to aid allocations?

Between 1998-99 and 2008-09 the percentage of DAC aid (bilateral plus imputed multilateral) directed at LDCs and other LICs increased from 45.2% to 57.8%, despite the fact that major recipients like India shifted category (see Table 5 below). The EU donor countries raised their aid to LDCs and other LICs from 49.9% to 55.5% in the same period.

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[14] The countries that had never been MICs before are Bhutan, India, Sudan, Timor-Leste, Nigeria, Pakistan, Sao Tomé and Principe, Vietnam.

[15] Sikkim (which voted to join India in 1975); Botswana (graduated in 1994); Cape Verde (2007); and Maldives (2011).

[16] http://www.unctad.org/Templates/WebFlyer.asp?intItemID=5810&lang=1

Table 5: Net disbursements as a per cent of total ODA, including imputed multilateral ODA

	1998-99						2008-09					
	LDC	Other LIC	LDC and other LIC	LMIC	UMIC	All MIC	LDC	Other LIC	LDC and other LIC	LMIC	UMIC	All MIC
TOTAL DAC	31.9	13.3	45.2	47.7	7.2	54.9	43.5	14.3	57.8	33.1	9.1	42.2
DAC-EU countries	38.5	11.4	49.9	40.9	9.3	50.2	42.7	12.8	55.5	33.6	10.9	44.5
France	35.3	11.3	46.6	43.5	10	53.5	34.4	15.7	50.1	32.6	17.2	49.8
Germany	32.8	10.1	42.9	47.7	9.4	57.1	35.8	10.7	46.5	40.6	12.8	53.4
Netherlands	42.1	10.9	53	37.5	9.4	46.9	54.5	13	67.5	24.6	7.8	32.4
Spain	20.6	10.7	31.3	57.4	11.3	68.7	34.8	8.2	43	46.1	10.9	57
United Kingdom	39.6	14.3	53.9	34.8	11.2	46	49.7	15.9	65.6	27.2	7.2	34.4
Canada	39.1	15.6	54.7	37.8	7.5	45.3	56.9	14.8	71.7	24	4.4	28.4
Japan	17.2	16.5	33.7	60.8	5.5	66.3	40.6	25.5	66.1	26.2	7.7	33.9
Norway	49.1	7.9	57	31.8	11.2	43	59.5	11.1	70.6	22.3	7.1	29.4
United States	30.4	11.3	41.7	56.7	1.6	58.3	43.4	13.2	56.6	36.6	6.8	43.4

Source: OECD, reordered by author. Excluding MADCTs (More Advanced Developing Countries and Territories) and amounts unspecified by country.

Aid to MICs went down as a consequence of this shift. The major donor to have most reduced its aid to MICs is Japan, halving the proportion of aid to MICs from over 66% to just under 34% in ten years. Canada and the Netherlands cut the share of aid given to MICs by about one third, while the UK, Norway and the US cut theirs by about one quarter. Despite cutting its aid allocation to MICs significantly from almost 70% in 1998-99, Spain still has the highest allocation with 57% in the most recent figures, followed by France and Germany. It is worth noting that DAC aid to the UMIC category increased by 26% during this period, possibly because the number of countries in that category increased from 37 in 2003 to 48 in 2011.

Box 1: Focus on DFID

In 2009 DFID spent a third of its bilateral programme in MICs, despite having set a target of only 10% in 2004.[17] In March 2011 DFID published plans to close 16 country programmes over the next four years, 12 of which are in MICs (the only LIC programmes to be closed are Burundi, Cambodia, Gambia and Niger). Of the remaining 27 bilateral country programmes, only 7 are MICs: India, Nigeria, Occupied Palestinian Territories, Pakistan, South Africa, Sudan and Yemen. All of these except South Africa are right at the bottom of the LMIC category, just above the LIC borderline.[18]

Including those country programmes that are winding down (and assuming that countries remain within their present classification), 36% of the UK's total bilateral aid spend over the next five years to 2015 will be in MICs. While aid in some MICs will wind down, aid to Nigeria, Pakistan and Yemen is set to double.

The figures for bilateral aid can differ substantially from those which include imputed multilateral aid. For instance, the UK's bilateral spend on MICs is only 22.3% in 2008-09, even lower than the 34.4% recorded when imputed multilateral aid is included. France's bilateral spend in MICs actually went up in the 2000s, but there is a reduction when imputed multilateral aid is added. There are no figures including imputed multilateral aid for EC institutions, presumably because the EU's multilateral spend is very small, fluctuating around 3% or 4% since 1990, compared to a DAC average of between 25% and 30%.

[17] According to DFID's 2009 Annual Report. The MICs bilateral programme spend figures includes all programmes above £1 million. Smaller programmes are not counted in this total.

[18] DFID (2011).

Just over 40% of EU institution bilateral aid was allocated to MICs in 2008-09, a decrease from 47.3 a decade earlier (as shown in Table 6 below). This is a reversal of the trend in the 1990s to increase aid to MICs. Bilateral DAC aid to MICs increased from 41.7% to 47.5% in the 1990s, while aid from the EU institutions to MICs almost doubled in that period, from 26.2% to 47.3%.

Table 6: Bilateral aid: how do the EU institutions compare to DAC overall?

	1988-89		1998-99		2008-09	
	EU institutions	DAC	EU institutions	DAC	EU institutions	DAC
LDCs	43.1	25.1	26.9	18.8	32.6	25.4
Other LICs	12.9	8.7	5.6	8.7	5.8	9.4
LDCs and other LICs	56	33.8	32.5	27.5	38.4	34.8
LMICs	21.9	34.6	37.3	40.1	26.5	30.7
UMICs	4.3	7.1	10.0	7.4	14.4	6.6
All MICs	26.2	41.7	47.3	47.5	40.9	37.3
MADCT and unallocated	17.8	24.5	20.4	25.1	20.7	27.8
Total	100	100	100	100	100	100

This increased focus on LICs and LDCs is all the more significant when we remember that there are 12 fewer 'Other LICs' today than a decade ago, and major aid recipients such as China and India are among those graduating to MIC status. Pakistan, Nigeria and Vietnam are among those countries recently re-classified as MICs by the World Bank but which appear as 'Other LICs' in this data, which is the latest available from the OECD.

Looking at aid shares by region it is clear that while aid to sub-Saharan Africa has increased as a percentage of total aid in the past decade, it is nowhere near the level of the end of the 1980s (see Table 7 below). Since then aid to Europe and the Middle East and North Africa has displaced aid to sub-Saharan Africa, with the other parts of the work remaining more or less the same.

Table 7: How the EU institutions compare to DAC aid by region?

	1988-89		1998-99		2008-09	
	EU institutions	DAC	EU institutions	DAC	EU institutions	DAC
Sub-Saharan Africa	60.7	28.0	33.1	21.3	37.6	27.0
South and Central Asia	10.1	12.8	6.5	10.6	9.7	13.5
Other Asia and Oceania	6.6	20.2	5.7	24.2	4.0	12.8
Middle East and North Africa	6.5	12.6	17.5	9.2	13.4	13.3
Latin America and Caribbean	9.8	10.7	11.4	12.2	8.6	8.0
Europe	1.6	2.1	12.5	5.1	15.8	3.5
Unspecified	4.7	13.7	13.3	17.6	11.0	21.9
TOTAL	100	100	100	100	100	100

Eleven of the top 15 recipients of EU institution aid in 1988-89 were in Africa, and all but one were LICs (see Annex 3). But by 1998-99 the top six recipients of EU aid were MICs in Europe and North Africa. In 2008-09 only six of the top 15 recipients were in sub-Saharan Africa, and seven were MICs. Predictably, the overall DAC figures are significantly different, with no bias towards EU neighbours. It is noticeable that India, China, Indonesia have been in the top 5 recipients for the past three decades. Eight of the top 15 in the most recent figures are MICs, compared to 6 in the previous two sets of data.

One final piece of useful information comes from the OECD's 2008 survey of aid allocation intentions, which showed a planned increase in country programmable aid of $3.8 billion between 2005 and 2010

for LDCs and $3 billion for other LICs.[19] A further $8 billion was yet unallocated, presumed for those two country categories. Aid to LMICs, by contrast, was set to reduce by $1.3 billion, but that was due to an expected $2.5 billion decrease in aid to Iraq. UMICs were set to receive about $1 billion more, mostly in the Mediterranean region. Twenty countries other than Iraq also were set to see aid decrease in the 2005-10 period, including five LICs and 12 LMICs (see annex 4).

Box 2: Focus on Spain

Spain is the now the sixth largest donor in the world, contributing more than 5% of ODA.[20] In 2003, Spanish aid was less than US$2 billion, but by 2009 its ODA had more than tripled US$6.9 billion, an increase from 0.23% of GNP to 0.44%. For historical, cultural and commercial reasons Spanish aid has a strong focus on Latin America, although aid to that region has reduced from over 50% to about 40% in recent years.

57% of Spain's ODA goes to MICs, down from almost 70% ten years ago. Spain has emphasised the importance of maintaining aid flows to middle-income countries and supported a series of UN conferences on cooperation with MICs. However, according to one analysis, Spain has since abandoned this theme and 'returned to that anomalous combination of a discourse suited to the Nordics with a very different aid reality.'[21] Spanish aid also aimed at one point to adapt the MDGs for the MICs, but later dropped the idea.[22]

[19] OECD (2008). The OECD defines CPA as the aid that remains after deducting humanitarian aid and debt relief, imputed student costs, administrative costs, promotion of development awareness, research and refugees in donor countries, food aid and aid from local governments, and core funding of NGOs.
[20] http://www.thebrokeronline.eu/en/Magazine/articles/When-volume-is-not-enough
[21] Alonso et al. (2007).
[22] ECPDM (2005).

3. Why give aid to MICs?

In his seminal research study on cooperation with MICs, which became the basic text for the series of UN conferences on the subject, Alonso (2007) sets out five main reasons for continued aid to MICs while Kanbur (2010) addresses the question differently (Table 8).

Table 8: Reasons to support development in MICs

Alonso (2007)	Kanbur (2010)
1. To contribute to the eradication of poverty	1. To help eradicate the 'pockets of poverty' that still exist in MICs
2. To consolidate the social and economic progress already achieved, and reduce the risk of falling back	2. Cross-border and global spillovers, and global public goods
3. To support MICs' contributions in the provision of international public goods	3. Knowledge transfer i.e. by engaging with MICs the agency gains knowledge which can then be useful for development assistance to LICs.
4. To help MICs serve as poles of development at the regional level	
5. To ensure that international aid system provides consistent incentives and rewards, (avoiding discrimination against countries which have made the largest advances).	

These are useful pointers, but not strictly reasons for giving aid to MICs. Rather, except for Alonso's fifth reason, they are reasons to support development in MICs. The two are very different. If it is considered important to support poverty reduction and development in MICs, different types of aid are among a range of means at the international community's disposal to do so. Below we take each question in turn:

- Why should the international community continue to support development in MICs?
- Should donors give aid to MICs as part of their development support?

3.1 Why should the international community continue to support development in MICs?

It may appear non-controversial that MICs should continue to be supported in their development, but there is one problematic issue worth bringing to the fore. As MICs, especially the larger ones, industrialise and develop trade capacity they become more competitive with the traditionally dominant OECD countries. The exodus of jobs to MICs such as China (manufacturing) and India (e.g. IT and call-centre), for example. The recent financial crisis has only served to underline how fast the larger emerging markets are growing compared to the high-income countries.

In such a context it is necessary to make a convincing argument that continued cooperation is a preferable strategy to competition. While those in the development community might favour cooperation, in reality, international relationships are likely to comprise a complex mixture of the two approaches.

It is unlikely for countries to act in a way which they do not see as in their national interest. Rich countries have been prepared to make marginal sacrifices for the very poorest group of countries, the LDCs, in terms of trade preferences under programmes such as the African Growth and Opportunity Act (AGOA) and the EU's Everything But Arms initiative, but have not made more substantial sacrifices such

as reducing agricultural subsidies. It is even less likely they will act against their national interests and voting constituencies in favour of countries that are apparently doing much better.

Clearly donors have their own narrow interests in mind when they consider foreign policy, including development policy. Strengthening relationships with MICs, including support for their development, is likely to enhance trading opportunities and security cooperation, among other high priorities. But these issues are not discussed in this paper which is uniquely interested in developmental outcomes for poor people.

Apart from narrow national interests there appear to be three main reasons for the continuing support for economic development and poverty reduction in MICs, corresponding to national, regional and global impacts (Table 9).

Table 9: Three reasons for supporting development and poverty reduction in MICs

National	Most poor people live in MICs
Regional	Spillover effects to nearby countries
Global	Crucial contribution to global public goods

First, about three-quarters of the world's poorest people (933 million people) live in MICs, corresponding to Alonso's and Kanbur's first reason.[23] Any strategy to support poverty reduction at a global level must therefore include a strategy for supporting poverty reduction in MICs at the national (and in some cases e.g. the large countries, sub-national) level. Given significant momentum behind poverty eradication in some rich countries this could be considered of strategic importance to politicians seeking votes.

Furthermore, it is argued that rich countries should ask whether their obligations cease when poorer countries reach an income level whereby theoretically (if they were totally equal) each citizen could exist just above extreme poverty levels, or whether they continue until citizens approximate to a standard of living much nearer those in rich countries.

Second, it is argued that MICs are not only important in themselves, but also for the countries close to them, acting as regional hubs or 'poles of development at the regional level', corresponding to Alonso's fourth and Kanbur's second reasons. The MICs played a decisive role in supporting the poorest countries through the latest financial crisis on account of well-developed trade relations and remittances.[24] As well as offering stable trading opportunities, these 'spillover effects' provided by MICs include debt relief, technical assistance and cooperation to support infrastructure investment, trade finance, institution building, public administration reform and humanitarian assistance.[25] One of the best ways to support poverty reduction in neighbouring LICs and LDCs, therefore, is to ensure the continued prosperity and stability of the MICs. The political upheavals of 2011 in North Africa and the Middle East imply a role for aid in supporting stability when unexpected crises occur.

And third, the MICs, especially the largest ones, are vital to achieving global public goods, corresponding to Alonso's third and Kanbur's second reasons. For example, the MICs contributed 41% of CO_2 emissions in 2007, and that number may now be significantly higher.[26] The larger MICs are involved in global peacekeeping, security and migration operations (usually under the auspices of the UN) and have their own aid programmes, comprising about half the participants in most global programs[27], and contributing money and expertise to the multilateral development banks. They are

[23] Sumner (2010).
[24] Te Velde et al. (2010).
[25] UN (2009).
[26] Alonso et al. (2007).
[27] UN (2009).

important actors in the prevention of global public 'bads' from problems including financial crises and infectious diseases.

For these three reasons, it is argued that it is in the international community's moral and strategic interest to continue to support MICs in their development. However, as countries become wealthier in income per capita terms, it is sensible to ask whether financial aid continues to be the most effective way to support MICs, especially give a financial context in which donor money needs to be allocated ever more efficiently.

3.2 Should donors give aid to MICs as part of their development support?

Financial aid is not synonymous with development support, but is one of a range of possible interventions to be considered. ODA is inevitably a less relevant feature of the economy for most MICs than for LICs. Indeed, the UN conference series placed far higher priority on other forms of international support, including architectural and regulatory issues such as ensuring a better context for trade and improving the intellectual property rights regime, enhancing dialogue and sharing between MICs, increasing MIC voice in the international financial institutions, and better management of migration and remittances.[28]

However, despite this strong focus on complementary measures (what the EU would call 'policy coherence'); many still see a role for ODA, albeit within a changing paradigm. Others do not. The following table presents the common reasons given for and against aid giving as an intervention to support poverty reduction and development in MICs (Table 10). (Many of the arguments elaborated here regarding aid to MICs are similar to those arguments for and against aid in general.)

Table 10: Common reasons given for and against aid to MICs

For	Against
Better value-for-money	Scarce resources
Crowding in private capital	Crowding out private capital
Moral hazard	Perverse incentives
Targeted interventions	Limited influence
Sub-national support	Fungibility
Support to civil society	Intergenerational poverty
Sharing expertise and knowledge transfer	

A waste of scarce resources or better value-for-money?

The major argument for reducing and even ending aid to MICs is that scarce resources must be allocated efficiently. Countries that have more resources (money) should fund their own development and poverty alleviation plans. As there is less need for money in MICs, needier countries should be prioritised for limited global aid funds.

On the other hand, allocation of resources is not just carried out on the basis of need, but also on the basis of likely impact, or effectiveness. Aid could be more effective in MICs precisely because it is relatively smaller as a percentage of GDP and government expenditure. The perennial problems of ownership and conditionality, dependency culture, absorption capacity (in terms of macroeconomic effects), are substantially absent when aid is very limited in size. MICs will generally have better governance structures, institutions and oversight mechanisms, meaning that aid is more likely to be put to good use.

In its latest reviews of bilateral and multilateral aid spend, the UK's Department for International Development (DFID) applied a 'needs-effectiveness' index to its decision making, allocating aid not

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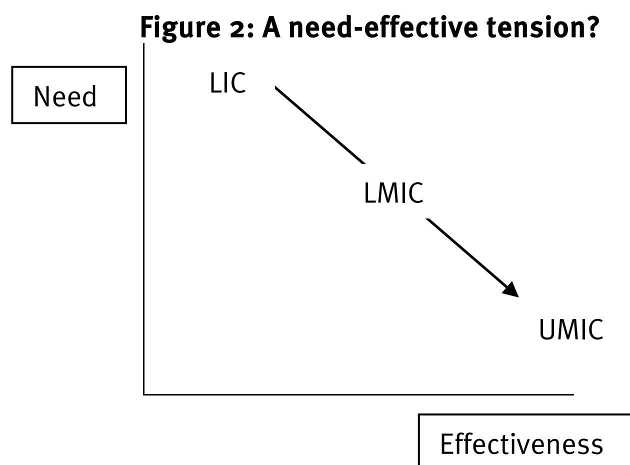
[28] UN (2007a).

only where it was most needed, but also where it would do most good. The 'need' part of the index looks at numbers of poor people, human development indicators and fragility, while the 'effectiveness' part assesses the 'institutional environment'. It is a recurrent theme in the literature that good quality institutions are associated with increased aid effectiveness.[29]

This way of working is at the heart of a focus on 'value-for-money', whereby the 'unit costs' of progress against poverty may be cheaper in some contexts over others. This approach can be criticised when it leads to lack of action in the hardest to reach communities or countries and skews aid towards easy wins. Nevertheless, if the same amount of money can lift twice as many people out of poverty in one context than in another that becomes an important consideration to acknowledge.

In the context of the MICs the 'needs' analysis would be in terms of average income, meaning that LICs are by definition needier than MICs. However, one could reasonably speculate that rising average incomes will generally lead to more effective institutions. Thus as countries move from LIC to LMIC to UMIC status, their need for aid reduces, but its effectiveness may increase. This could be represented graphically as follows:

Figure 2: A need-effective tension?



A caveat to this analysis is that as in all budgetary decision making, the essential should be prioritised over the important. However, even through this lens spending in MICs might come out positively. While theoretically MICs should be managing poverty better, the reality is different, meaning that responses to present need are often just as urgent in MICs as in LICs. India is the best example of this complex reality, a country growing rapidly with hundreds of billions of dollars held in reserves, which is nevertheless home to more poor people than the whole of Africa.

The concept of intergenerational poverty is one that should also be considered here. When the future prospects of poor countries are introduced the needs side of the equation is tipped in favour of the least developed countries and spending aid in MICs may become harder to justify. Influential economist Paul Collier has even gone so far as to argue that, 'the international community basically doesn't have a role in the MICs'[30], arguing that the future for poor people and their descendents in MICs looks relatively bright. If we treat future poor people as a significant variable, it is the most fragile 'Bottom Billion' countries which merit almost exclusive attention.

Crowding in or out?

Some have argued that aid, if spent in particular ways, plays a 'crowding-in' function, encouraging private capital to invest. Private lenders or investors, according to this analysis, will base their decisions, either formally or informally, on signals from official lenders, or they may engage in formal

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[29] Glennie (2008).

[30] Conversation with Andy Sumner on IDS website (http://www.mixcloud.com/ids/paul-collier-and-andy-sumner-in-discussion-on-the-ids-paper-the-new-bottom-billion/).

public-private partnerships. Better infrastructure and a more highly educated workforce, financed by public money, is also likely to encourage the private sector to invest. Others say that aid can 'crowd out' foreign private investment, and distort normal market operations, for instance by inflating wages and attracting top performers away from the private sector.

Aid seems more likely to crowd in private funds playing the role of catalyst in stable environments where the market is stronger i.e. MICs. The Asian Development Bank calculates that Asian countries will require $600 billion a year for investment in infrastructure and argues that, 'Obviously, such level of investment can only be achieved through a public-private sector partnership.'[31]

Perverse incentives or incentivising progressive decision making?

One major argument against continuing aid to MICs is that it will undermine pressure for reforms that could lead to better distribution of wealth and income. Now that countries have resources at their disposal, they need to engage in a strategy to allocate those resources most appropriately to reduce poverty. Such choices (such as increased tax collection) can be politically fraught, and aid might succeed only in lessening the likelihood of their implementation.

It is certainly true that aid can do this. But there are two important caveats. Firstly, there is as much literature suggesting that aid can play a role in incentivising better tax intake and budget resource allocation, as there is to suggest that it undermines progress.[32] And secondly, it is more likely a priori that these perverse incentives will come into play in LICs rather than MICs where aid plays a bigger role in the economy and the government's budget. It is unlikely, for example, that the negligible amounts of aid received by countries like India and China, in proportion to their overall incomes, will have any significant impact on any big decisions taken by the government (except in catalytic terms, as we shall see shortly).

Finally, some argue (Alonso's fifth reason) that aid reductions as a consequence of economic growth may constitute a moral hazard, disincentivising graduation from LIC to MIC status.[33]

Targeted interventions or limited influence?

Given the relatively small sums involved in the bigger or richer countries, donors will have very limited leverage over policy making. Clearly aid donors seek influence, but from a development perspective the loss of it is by no means a bad thing. There is consensus in the literature that increased 'ownership' is vital to making aid more effective, yet problems of 'ownership' continue to dog attempts to make aid to aid dependent states more effective.

While influence will be exerted in a more limited way in MICs, it can still be important. While aid may no longer be needed to plug a financing gap, it can be useful if targeted at certain key areas of the government's budget which might otherwise be underfunded. In some countries these areas would include the judiciary, human rights work and policing. In others, social sectors such as education and health (including sector budget support).[34]

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[31] UN (2007c).
[32] See Glennie (2008) Chapter 5 for a discussion of this literature.
[33] Alonso (2007).
[34] According to Alonso (2007) Between 2000-2004 about 78% of aid to MICs was sectoral aid (to social infrastructure and services, economics infrastructure, productive sectors, or mulitsectoral) compared to 57% of LIC and LDC aid. LICs and LDCs receive much more aid in the form of "general aid", debt relief and emergency aid. Of this sectoral aid, the vast majority goes to social infrastructure and services (56% in 2000-2004) and economic infrastructure (23%). The rest goes to the productive sectors (9%) and multisectoral (12%).

Box 3: Two examples of targeted interventions: aid for trade, and tax reform

Aid for trade. MICs have difficulty in moving to a process of accumulation of technological capacities, and away from a dependence on raw materials. Aid could complement changes in the international trade and IPR context.35 The UN says that, 'Middle-income countries share the challenge of reducing structural and geographical concentration in their exports and strengthening their position in the multilateral trading system to mitigate their vulnerability to external shocks in trade flows and in commodity prices.'[36]

The G77 group of developing countries has emphasised the need for a greater emphasis on capacity building, including an expansion of the Aid for Trade concept in MICs to have a meaningful impact on trade and production prospects, as well as on technological development and knowledge generation.[37] The UN suggests that aid resources in MICs should be shifted to 'productive sectors to stimulate employment generation and sustainable development, especially in contexts where significant social sector progress has already been achieved.'[38]

Support for tax reform. One way to address the distribution problem common in MICs is through an improved tax system. According to the UN, 'If countries are to make progress in reducing inequality and poverty, they need a taxation system that is efficient, flexible and fair and that can provide the government with sufficient funds. In many MICs this implies significant changes, and in others a substantial reform. In many cases the individual income tax must play a bigger role, and at the same time corporate income tax policy needs to consider problems relating to the tax base, such as excessive depreciation allowances and other overly generous tax incentives.'[39]

The UN identifies three areas in which the international cooperation can support reform: the design of reforms; technical and institutional strengthening of tax administration; and international cooperation in areas such as double taxation and tax fraud.[40]

Fungibility

While aid money can be targeted on a particular sector, and accounted for as such, money is ultimately fungible, meaning that in reality other monies have been freed up for spending elsewhere. Fundamentally, then, aid to the government cannot be clearly targeted. A problem of perverse incentives may again arise, if the national government decides not to fund crucial sectors or geographical areas properly, because they are receiving external help.

The problem of fungibility is ultimately insoluble. While there are some studies try to take it into account when assessing government spend (such as Lawson, forthcoming) there will always be a suspicion that aid supporting one government sector my lead to money elsewhere going astray. In Egypt, for example, the estimated size of ex-President Mubarak's personal fortune is roughly the same as the amount of aid Egypt has received since 1981 when Mubarak came to power. Some estimate that as much as 40% of aid actually supports arms expenditure (Collier 2008). However, the problem of fungibility is not unique to MICs. It is not clear why this would be considered a particular problem for MIC aid rather than aid in general.

Sub-national support

Depending on the context, aid to sub-national governments may continue to be important, even when national income averages improve. India is usually given as an example of where this approach might be appropriate, given the vast differences in living standards in, for example, Kerala and Bihar.

Sharing expertise and knowledge transfer

While MICs have more money than before, they frequently still lack capacity in many areas of public policy and research. Donors can fund experts (not only from donor countries) to offer technical support, especially on areas they are particularly strong in (e.g. for the EU, regional integration). The importance of technical assistance from MDBs and other IFIs in developing new financial instruments and

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[35] Alonso et al. (2007).
[36] UN (2009).
[37] UN (2007c).
[38] UN (2009).
[39] Ibid.
[40] Ibid.

institutions is appreciated by MICs, who expressed concern, in one survey, that this expertise would be unavailable outside of a donor-recipient relationship.[41] Development agencies may choose to stay in MICs (even UMICs) to learn and transmit lessons to other countries in their portfolio (LICs or LMICs). Triangular (or trilateral) cooperation is a different iteration of this, where traditional donors fund knowledge sharing and other development programmes between developing countries.

Support to civil society

While in the poorest country the problem is lack of resources, in the MICs, the richer they get in average terms, the problem is the poor distribution of those resources. These high levels of inequality can give rise to considerable social tension. Strengthening civil society is a key method to increase accountability of the state to its poorest citizens, on issues such as the provision of public goods and, in some countries, respect for basic human rights. Obviously this will have to be treated carefully politically, but failure to support civil society may also lead to the donor losing credibility in the wider population.

[41] Quoted in Fenton (2008).

4. Conclusion

We have reviewed the level and use of aid to MICs, and looked at the arguments for and against. MICs are different to LICs. They have more resources and usually have stronger institutional capacity. However, the differences should not be exaggerated as the categories are relatively arbitrary and the MICs themselves are a very varied group of countries. Many factors apart from income per capita, and including broader assessments of human, economic and institutional development, are equally as important in aid allocation, as the LDC process (while far from perfect) implies. Aid allocation should reflect capacity to use external financing effectively as well as need, and aid should not be switched off as countries cross an artificial barrier, but should be tapered.

The graduation of countries from LIC to MIC status in the last decade, while important, should be treated with caution for two reasons. First, when five major countries (Pakistan, India, Nigeria, China and Indonesia) are excluded, there has been almost no change in the proportion of poor people living in MICs since 1990. Second, the tendency of countries to flip back and forth between LIC and MIC implies that care should be taken when basing aid allocation policies around this analysis. MICs, especially LMICs, are very susceptible to shocks. International development partners need to be flexible, providing for graduation to MIC status, but also for possible regression.

International support to MICs, including financial aid, continues to play an important role in global development. Three reasons were presented for continued development support to MICs: national, regional and global. Although LICs tend to have higher percentages of people in poverty, the vast majority of poor people live in MICs. Furthermore they contribute to regional development through spill-over effects, and also contribute to global public goods. Development support can take a number of forms, including non-aid. However, financial support can be justified for specific purposes and can take a number of forms, including grant aid, but also technical cooperation, loans, and blended projects. Shock facilities are particularly important for MICs.

Arbitrary targets for aid to MICs or LDCs/LICs may be unhelpful, it is argued, given the shifting geography of poverty and value for money considerations. Aid has two functions: filling a financing gap and incentivising particular decisions. In aid dependent countries it plays both these roles, while in non-aid dependent countries (either very large or relatively wealthy) it tends only to play the incentivising, or catalytic, role. The role aid plays in a country's development has as much to do with the size of that country in absolute terms as average income. The large new MICs (i.e. the PICNIs) and most of the old MICs have never been aid dependent.

Based on this analysis, it would be ideal to be able to contribute to a formula to help with aid allocation decisions, such as the one used by DFID in its 2011 Bilateral Aid Review. However, it is the following two conclusions that seem most appropriate. They are not an attempt to answer allocation decisions to MICs, but a contribution to understanding the roles aid plays in MICs.

A: Orderly graduation from aid dependence

Graduating to MIC status brings risks as well as opportunities. Those countries that are graduating from aid dependence to more sustainable levels of aid need to set in train policies to smooth their graduation, supported by key donor allies. The idea that countries should not have aid ended abruptly, but should rather have an orderly graduation from aid dependence, is non-controversial. It depends more than anything on the capacity of the aid recipient government to manage its flows in a healthy way.

One consequence for countries when they graduate to MIC status is that certain channels of finance become increasingly available while others start to close off. In the former case, this is not a formal process, simply a reflection that, in general, MICs are considered by bankers to be better targets for

lending and investing. In the latter case, there is a formal graduation process led by the World Bank whereby concessional financing from IDA phases out. According to one Oxfam study, 'There may be weak external debt positions and other credit constraints. This leads to a number of MICs, termed 'gap countries' being ineligible for IDA financing other than on an exceptional basis, since per capita GNI is above the IDA cut-off of $895, yet not creditworthy for IBRD or other non-concessional borrowing, and with limited capacity to carry MDB debt.'[42] For the handful of countries leaving LDC status, preferential trading access will also be affected. On top of this, we have seen how easy it is to fall back from MIC to LIC status.

While progress has been impressive in the last decade, contingencies should be planned for because, as Alonso makes clear, progress is highly vulnerable to external shocks as well as internal crises (including the political, financial, economic and natural varieties. According to the UN conference series, what is needed is not a 'rigid policy of abrupt graduation, but rather for a gradualist strategy in dealing with these countries. That strategy could include aid guidelines for relatively homogeneous groups of developing countries that would take account of factors that go beyond Gross Domestic Product alone.'[43]

Box 4: Aid to Vietnam as it enters MIC status

In 2010, the year Vietnam became a MIC for the first time, the Vietnamese Aid Effectiveness Forum published 'Enhancing Aid Effectiveness for Sustainable Development'. It is, effectively, a strategy to manage gradually reducing aid flows.

As reaching a lower MIC status Vietnam needs to maximize its strengths by tapping its full potentialities and developing qualified human resources for creating a breakthrough in its socio-economic development and avoiding the 'traps of middle-income countries'...

For the mobilization of ODA resources for development, in the context of MIC status, Vietnam will be facing challenges in scale, structure, and condition and aid modality. The grant aid will focus more on the technical assistance, technology transfer, capacity building etc. And at the same time there are new windows of credit with less concession etc. In addition, it is important to enhance formulation and implementation of program based approaches (PBAs) (including general budget support and targeted budget support) as a catalyst for improving national / sector frameworks, institutional capacity and country system.

In the above context, policies for attracting and using ODA should be reformulated accordingly and focus more on effective use of aid and closely link with other sources for development with the aim to maximize the support of the donor community for Vietnam to develop socio-economic infrastructure, poverty reduction, contributing to achieving the Millennium Development Goals by 2015.[44]

Even rich countries like Ireland and Greece have recently received crisis financing so ensuring that reserves are available to help countries undergoing shocks is not technically development aid. However, MICs are generally more open than both LICs and HICs, which leaves them particularly open to shocks.45 Given the frequent fragility of their progress, and their increasing openness to international financial markets and the risks associated with them, they are possibly the countries most likely to need emergency support as they seek to stabilise gains in income. In particular, many MICs do not have social spending sufficiently entrenched to resist shock.[46]

According to Enrique Iglesias, President of Inter-American Development Bank, 'The Latin American region could become even more vulnerable to crises, if the will to grant large official packages as were granted in recent crises, is absent in practice when the need comes'.[47] The UN put it like this:

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[42] Fenton (2008).
[43] UN (2007b).
[44] Vietnamese Aid Effectiveness Forum (2010).
[45] Alonso (2007).
[46] Fenton (2008).
[47] Ibid.

'Owing to the growing impact of the global financial and economic crisis on middle-income countries and other developing countries, international financial institutions need urgently to deliver a timely and adequate transfer of financial resources to these economies. Sufficient liquidity is needed to compensate for the sharp reversal in international private financial inflows and to ensure that long-term debt sustainability is achieved and sustained. Moreover, the policy space in these economies needs to be enlarged so that counter-cyclical policies can be adopted and the adverse effects of the crisis on the achievement of long-run development goals can be mitigated. This will, however, require a substantial change in the lending framework of international financial institutions to avoid repeating the same compounding effects associated with the lending policies to some middle-income countries as during the crises of the past.'

An evaluation of the World Bank's work in MICs found that, 'during the financial crises of the 1990s and early 2000s, neither the World Bank nor the authorities had strong contingency plans in place to protect the poor', for example through strengthened social safety nets. It looks from early evaluations that the World Bank performed better in the recent crisis, getting money to countries fast.[48]

B: Aid as a non-essential catalyst

Clearly aid does not just play the role of filling a financing gap. Its role as catalyst and incentive for change is just as important in many countries. As countries become richer the constraints hindering their growth are derived, as Alonso puts it, 'not so much from extreme shortages, but from unfulfilled needs for their own development'. Alonso continues: 'For this reason, what is relevant is not so much the direct effect of the amount of resources channelled by aid, but the role that international cooperation may play in modifying the framework of incentives in which agents operate.'[49]

Thus aid has a role to support attempts to respond to the specific problems and priorities of MICs (see Annex 1), not as a large source of development finance, but as a strategic catalyst for change and consolidation of progress. The key is to focus not so much on what the money buys, but on what incentives it creates.[50] This distinction between the two functions of aid does not depend solely on income status. It also depends on the absolute size of a country. The five very large countries that have recently become MICs, the PICNIs, are by no means graduating to a stage of non-aid dependence. With the exception of Pakistan, they have relied on aid for under 1% of their GNI for at least three decades. While aid is decreasing, it was never at a high level.

In other words aid has already been carrying out the catalytic/incentivising function in very large LICs, not just in MICs. Annex 2 shows how (non-)aid dependent, in terms of aid to GNI, many MICs have been for the last three decades – smaller LICs tend to be more aid dependent, with aid to GNI ranging from 5-20% of GNI, and even higher.[51] As well as the larger LICs/MICs, the longer term MICs have been receiving low levels of aid for some time. This aid has sought to play a catalytic role. That does not mean that aid has not played a significant role in their development, and has sometimes arrived in quite substantial absolute quantities. But it would be wrong to imply a relationship of dependence or that the aid was essential.

Different aid strategies are required for different types of aid recipient. Those graduating from aid dependence need continued and well planned support in order to take advantage of the opportunities and mitigate the risks of their new status. They will take progressively more control of the aid strategy

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[48] Te Velde (2010).
[49] Alonso et al. (2007).
[50] Eyben and Lister (2004) set out four ways that donors can use their money, and discuss at some length the pros and cons in a MIC environment: direct government to government aid; indirect government to government aid via a multilateral organisation; direct government to country (civil society/private sector) aid; indirect government to country, via civil society in the donor country.
[51] Note that aid as a proportion of government expenditure is also an important factor to consider, but statistics on this seem to be particularly weak so they are not yet included in this analysis.

as they become less dependent on aid.[52] But for those countries that have never been dependent on aid (or at least not for decades), talk of graduation is misleading. The shift to MIC status is unlikely to mean very much in reality for the poorest members of these societies, and the catalytic aid interventions that have often helped them in the past will be just as relevant now as ever.

[52] Vietnam, for example, now has a graduation strategy agreed with donors.

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Annex 1

What are the development priorities for MICs in the coming decade?

The MICs requirement for enhanced and differentiated development support was recognised by the holding of three UN international conferences on MICs in Madrid (March 2007), San Salvador (October 2007) and Windhoek (August 2008), along with a regional conference in Cairo (March 2008) at which the World Bank and African Development Bank discussed how to align their services better to African MIC needs. The outcome statements of these conferences on the role of the international community in supporting development in the MICs are a fairly good reflection of the state of the debate. The three common priorities identified for this diverse group of countries are:[53]

1. Consolidating efficient and credible institutions:

As well as inefficiency, institutions in MICs suffer from a lack of credibility, often linked to very high levels of inequality and the failure to provide public goods. According to the UN, 37 MICs have seen significant poverty reduction in the past two decades, but poverty has increased or stayed unchanged in at least 37 others MICs.[54]

If broad poverty persists in countries whose per capita income is rising, the problem is increasingly about distribution rather than lack of capital. Inequality has risen significantly in over half of MICs in the past decade. The El Salvador conference declared that, 'the development of middle-income countries is hindered by disparities existing within them; redressing such disparities is the primary responsibility of their governments with the support of bilateral and multilateral cooperation donors, which represents an important component of their development.'[55]

2. Reducing vulnerabilities associated with integration into international financial markets:

MICs generally have more open markets than both LICs and HICs. They are not as fully integrated into the world economy as the HICs, but they are significantly more integrated than the LICs. According to the World Bank, the number of MICs with capital market credit ratings has more than doubled since the mid-1990s.[56]

According to a UN communiqué on MICs in 2009, 'Most middle-income countries have experienced an accelerated integration into the global economy over the past two decades, gaining greater access to international private capital inflows and expanding their trade flows. Some have clearly benefited from global economic integration, while others have become more vulnerable to external shocks... The current global financial and economic crisis has exemplified the vulnerability of middle-income countries in their high dependence on international trade, commodity prices and capital inflows.'[57]

3. Improving competitive capacity through productive transformation and technological progress:

MICs also need specific support to move their economies on from primary production, which tends to depend on natural resources and unskilled labour, towards products requiring more technology and value added. These changes are complex, especially where institutions are weak, and a favourable international context is therefore vital.

The El Salvador conference added a fourth priority, namely harnessing the development benefits of migration. In Windhoek three specific sectors were singled out for emphasis – food, energy and climate issues – and the fact that 'current debt initiatives do not adequately address the needs of MICs' was also recognised. A UN General Assembly communiqué about development in MICs published in August

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[53] UN (2007a).
[54] UN (2009).
[55] UN (2007b).
[56] World Bank Independent Evaluation Group (2007).
[57] UN (2009).

2009 focuses particularly on poverty and inequality as major challenges, and emphasises infrastructure and social sector spending, as well as some of the topics already mentioned. It attempts to identify specific foci for social sector spending but finds it hard to go beyond platitudes with such a diverse range of countries.

It is also worth noting that an evaluation of World Bank work in MICs indentifies three priorities for future engagement: inequality, combating corruption, and protecting the environment.[58]

[58] Te Velde (2010).

Annex 2

Table 11: How aid dependent are the MICs?

Note – the only MICs listed are those with at least 500,000 people living in income poverty according to most recent statistics.

Country (MIC)	ODA as % of GNI, average 1980s	1990s	2000s	2008	Poor people, million (under $1.25 per day, 2008)	% of total	Year of graduation
Thailand	1.08	0.61	0.01	0	1.3	0.1	LMIC
Russian Federation	0	0.4	0.38	0	2.8	0.2	UMIC
Mexico	0.08	0.07	0.02	0.01	4.2	0.3	UMIC
Venezuela, RB	0.04	0.06	0.05	0.02	1.0	0.1	UMIC
China	0.35	0.46	0.08	0.03	207.6	15.3	LMIC
Brazil	0.07	0.03	0.03	0.03	9.9	0.7	UMIC
Iran, Islamic Rep.	0.03	0.17	0.08	0.03	1.4	0.1	UMIC
Philippines	1.66	1.74	0.57	0.04	19.7	1.5	LMIC
Argentina	0.09	0.07	0.06	0.04	1.3	0.1	UMIC
Malaysia	0.67	0.22	0.1	0.07	0.5	0	UMIC
Turkmenistan	0	0.91	0.69	0.11	1.1	0.1	2000
India	0.81	0.59	0.21	0.17	455.8	33.6	2007
Indonesia	1.22	1.16	0.61	0.25	66.1	4.9	2003
Turkey	0.61	0.27	0.12	0.28	1.9	0.1	UMIC
Ukraine	0	0	0.4	0.35	0.9	0.1	2002
Peru	1.48	1.09	0.65	0.39	2.2	0.2	UMIC
Colombia	0.22	0.24	0.48	0.42	7.0	0.5	UMIC
South Africa	0	0.3	0.35	0.42	11.5	0.9	UMIC
Ecuador	1.28	1.39	0.67	0.43	0.6	0	LMIC
Angola*	2.02	8.7	2.86	0.52	7.8	0.6	2004
Nigeria	0.33	0.84	0.73	0.66	88.6	6.5	2008
Uzbekistan	0	0.67	1.36	0.67	11.8	0.9	2009
Egypt, Arab Rep.	5.35	5.87	1.19	0.82	1.5	0.1	LMIC
Pakistan	2.86	1.93	1.65	0.91	35.2	2.6	2008
Yemen, Rep.*	0	5.84	2.73	1.23	3.7	0.3	2009
Guatemala	1.66	1.73	1.25	1.39	1.5	0.1	LMIC
Morocco	3.78	2.52	1.31	1.39	0.8	0.1	LMIC
Sri Lanka	8.51	5.18	2.6	1.84	2.6	0.2	LMIC
Cameroon	2.7	6.62	5.67	2.32	5.3	0.4	2005
Swaziland	0	3.15	1.7	2.38	0.7	0.1	LMIC
Namibia	1.1	5.17	2.8	2.4	0.8	0.1	UMIC
Cote d'Ivoire	2.59	8.77	2.68	2.75	4.2	0.3	2008
Vietnam	1.97	4.03	3.97	2.91	18.0	1.3	2009

Papua New Guinea	11.96	8.96	6.45	3.84	1.7	0.1	2001
Bolivia	5.7	9.98	7.34	3.89	1.1	0.1	LMIC
Honduras	6.75	10.72	6.2	4.12	1.3	0.1	LMIC
Sudan*	7.21	4.35	4.16	4.55	No data	-	2007
Congo, Rep.	4.9	11.97	6.99	6.08	1.8	0.1	2005
Lesotho*	14.48	9.67	5.82	7.01	0.8	0.1	2005
Georgia	0	5.09	6.12	7.03	0.6	0	2003
Ghana	6.32	9.86	11.21	7.89	6.7	0.5	2011**
Senegal*	12.14	11.88	8.89	8.03	3.8	0.3	2009
Nicaragua	8.43	30.73	17.89	11.94	0.9	0.1	2005

Source: Author's calculation based on WDI
*LDC
**Expected to graduate in 2011

Annex 3

Table 12: Top 15 ODA recipients in last 20 years from EU Institutions (% of total)[59]

1988-89		1998-99		2008-09	
Cote d'Ivoire	6.6	Morocco	5.1	Turkey	4.6
India	5.1	Egypt	3.7	Palestinian Adm. Areas	4.5
Ethiopia	4.0	Bosnia-Herzegovina	3.5	Afghanistan	2.8
Cameroon	3.5	Ex-Yugoslavia	3.0	Ethiopia	2.4
Bangladesh	3.1	Algeria	2.6	Serbia	2.3
Mozambique	3.0	Tunisia	2.5	Morocco	2.3
Kenya	2.7	South Africa	2.0	Sudan	1.9
Egypt	2.7	Ethiopia	1.9	Congo, DR	1.7
Sudan	2.4	Albania	1.9	Ukraine	1.6
Congo, DR	1.8	Mozambique	1.6	Egypt	1.5
Tanzania	1.7	Mauritania	1.6	Uganda	1.5
Senegal	1.7	Malawi	1.6	Mozambique	1.4
China	1.7	Senegal	1.5	Bangladesh	1.2
Malawi	1.6	Bangladesh	1.4	Tanzania	1.2
Chad	1.6	Turkey	1.4	South Africa	1.2

Table 13: Top 15 ODA recipients in last 20 years from DAC (% of total)[60]

1988-89		1998-99		2008-09	
Indonesia	4.2	Indonesia	4.0	Iraq	4.7
Egypt	3.1	China	3.8	Afghanistan	3.3
India	2.9	India	2.6	Indonesia	2.1
China	2.8	Egypt	2.6	China	2.0
Israel	2.7	Thailand	1.8	India	1.9
Pakistan	2.1	Philippines	1.6	Viet Nam	1.6
Bangladesh	2.0	Viet Nam	1.5	Sudan	1.4
Philippines	1.8	Bangladesh	1.4	Ethiopia	1.4
Tanzania	1.5	Mozambique	1.2	Cote d'Ivoire	1.3
Mozambique	1.4	Tanzania	1.2	Palestinian Adm. Areas	1.1
Thailand	1.4	Bosnia-Herzegovina	1.1	Tanzania	1.0
Kenya	1.3	Pakistan	1.0	Mozambique	1.0
Turkey	1.1	Cote d'Ivoire	0.9	Bangladesh	1.0
Ethiopia	1.0	Peru	0.8	Egypt	1.0
Sudan	1.0	Morocco	0.8	Kenya	0.9

[59] OECD aid statistics found at http://www.oecd.org/document/49/0,3746,en_2649_34447_46582641_1_1_1_1,00.html
[60] Ibid.

Annex 4

Table 14: Countries projected to receive a decrease in total DAC aid from 2005-2010[61]

	Constant 2005 USD million			
Country	2005	2010	% decrease	Country class.
Grenada	33	3	90	UMIC
Thailand	778	325	58	LMIC
Iraq	7,286	4,784	34	LMIC
Chile	73	49	34	UMIC
Cape Verde	119	85	28	LMIC
Bhutan	81	60	27	LMIC
Eritrea	171	127	26	LIC
Egypt	1,114	838	25	LMIC
Brazil	329	246	25	UMIC
Bosnia-Herzegovina	439	359	18	UMIC
Timor-Leste	176	145	18	LMIC
China	2,378	1,993	16	LMIC
Chad	233	195	16	LIC
Tajikistan	167	140	16	LIC
Sri Lanka	844	714	15	LMIC
Guinea	150	127	15	LIC
Senegal	560	489	13	LMIC
Madagascar	576	520	10	LIC
Jordan	548	496	10	LMIC
Honduras	431	388	10	LMIC
India	3,142	2,925	7	LMIC

[61] OECD data found at http://www.oecd.org/dataoecd/37/20/40636926.pdf

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