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DEVELOPMENT COOPERATION WITH MIDDLE-INCOME COUNTRIES

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Development cooperation with middle-income countries

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November 2011

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1 Introduction[1]

Only flows to countries that are on the DAC list of recipients can be labelled Official Development Assistance (ODA). The countries on that list however are a mixed bag. Based on a World Bank classification, the DAC list for instance includes Burundi, with an income per capita in 2009 of $150, and Brazil, with an income per capita in 2009 of $ 8840. Burundi, on this count, is 59 times poorer than Brazil. And there is not just income. Burundi is small, landlocked, politically and institutionally unstable, with an unimpressive record in terms of economic growth, a modest player in Africa and an insignificant player in the world. Brazil by contrast is huge, rich in natural resources, technologically sophisticated, growing fast, ambitious, and a major player on the world scene. Recently, it has even started to think about setting up its own aid agency (The Economist, 2011a). How more heterogeneous can one get? One can pick similar contrasting pairs from the DAC list, such as DRCongo and China, or Niger and India. How much aid, in pursuit of which development objectives, addressing which constraints in which sectors, using which modalities and channels: surely no single strategy can fit such dissimilar realities. What constitutes a sensible donor strategy in one country may be very inadequate in another. A differentiated strategy is called for.

Many donors have explicit strategies to help answer such questions. Belgium has no policy document guiding its decisions, and was advised by the 2010 DAC Peer Review to fill this gap. This background study provides an input in the elaboration of such a diversified strategy. It looks at how development cooperation with middle-income countries differs from that with poorer countries.

Although some 42% of all bilateral ODA of DAC members in 2008-2009 is destined to middle income countries, it is difficult to find information on the rationale and modalities of development cooperation with MICs that goes beyond the usual donor rhetoric. Donors have plenty of publicly available documents that explain convincingly why and how they help low income countries. In contrast, aid to MICs seems to be the aid that dare not speak its name. Given the dearth of publicly available strategic documents, this study mostly focuses on more generic donor documents and on the academic literature.

In section two we look at the different definitions that are being used for MICs. In section three we illustrate to what extent MICs differ from LICs. The analysis suggests important dimensions policy makers must take into account when devising a MIC strategy. In the fourth section we look at substantive arguments for donors to provide aid to MICs, notwithstanding the fact that they are on average better off than their LIC cousins. The fifth section argues that the aid effectiveness agenda, and in particular the Paris Declaration, was not conceived with the MICs in mind, and what the lessons are from this analysis when conceiving a MIC strategy. The sixth section briefly describes how a number of donors have differentiated their development cooperation towards their partner countries. The final section lists the main conclusions.

[1] This discussion paper is part of a background study commissioned by the Belgian Directorate General of Development Cooperation (DGD). The study was produced by the "O*Platform on Aid Effectiveness and Aid Architecture" at the Institute of Development Policy and Management (IOB), University of Antwerp, with funding from the Flemish Interuniversity Council (VLIR).

2 Definition MICs

2.1 The World Bank classification

Alleviating poverty constitutes the primary official justification for providing aid, and an obvious and readily available indicator of well-being at country level is income per capita. For this reason bilateral and multilateral aid agencies all tend to use country rankings by income (or by criteria that are largely income-based) as an important criterion to justify their selection of beneficiary countries (Harris et al., 2009). Multilateral Development Banks, in particular, use per capita income as a key parameter to guide the volumes and terms of assistance provided. The World Bank has played a leading role in income-based country classifications that have provided inspiration for many other donors. For this reason, we start our search for definitions at the World Bank.

The primary World Bank criterion for classifying economies is gross national income (GNI) per capita, measured in US dollars, and calculated using the World Bank Atlas method[2]. Based on this measure, the classifications used since July 2011 are (World Bank fiscal year 2012, using 2010 data):

- Low income countries[3] (LIC): ≤ US$1,005 per capita (35 countries)
- Middle Income countries (MIC): US$ 1,006 - US$12,275 per capita (110 countries)
- High income countries (HIC): ≥ 12,276 per capita. (70 countries)

As the MIC-category is very broad, with those at the top of the band over 12 times wealthier than those at the bottom, it is further broken down into two subgroups:

- Lower middle income countries (LMIC): US$1,006 – US$3,975 per capita (56 countries)
- Upper middle income countries (UMIC): US$3.976 – US$12,275 per capita (54 countries)

The classifications are updated annually to incorporate the effect of international inflation.

Studying country categories over time should be done with caution. The evolution of the number of countries in any given category is in fact the compound effect of two dynamics: new countries being included in the statistics and countries being reclassified. Between 1989 and the mid-nineties, the overall number of countries in the World Bank data increased considerably due to the emergence of newly independent states (former USSR and Yugoslavia) and the classification of countries that were not listed before (e.g. due to a lack of data). The increase in LICs and MICs during that period can therefore be largely explained by the inclusion of new

[2] The World Bank's official estimates of countries' relative economic size are based on GNI, which is converted to US dollars using the Atlas Method. The Atlas Method uses three-year averages of a country's exchange rate. An alternative conversion method is the Purchasing Power Parity (PPP) method. The PPP method starts from the finding that the purchasing power of 1 US$ differs from country to country and therefore takes into account the number of units of a country's currency that is required to buy the same amount of goods and services in another country. For a number of reasons, even a free market exchange rate does not naturally expresses PPPs. Because of the high time and cost and time involved in organising detailed price surveys, PPP numbers are not available on an annual basis, but only for every 3-5 years. For intermediary years, values are extrapolated. Nor are PPPs available for all countries.

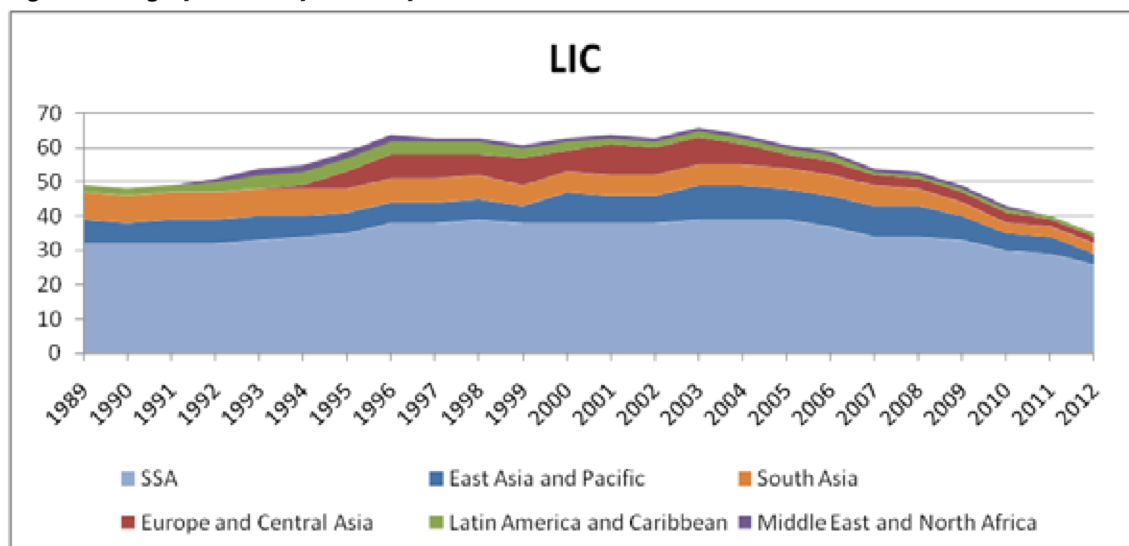
The GNI of developing countries measured in PPP terms generally exceeds their GNI using the Atlas method. This is mainly due to the fact that the relatively low prices of non-traded goods in developing countries have an impact on the PPP measure, but not on the Atlas conversion.

[3] The income classifications are used for all 187 World Bank member countries and other economies with populations of more than 30,000 (213 in total). We use the general abbreviation of low income country, incorporating also low income economies that are not countries.

countries rather than by a reclassification of existing countries.

From the middle of the nineties onwards, the total number of countries has however remained stable. Figure 1 illustrates how throughout the nineties the number of LICs increased to a peak of 66 in 2003:

Figure 1: Geographical composition of LICs [4]



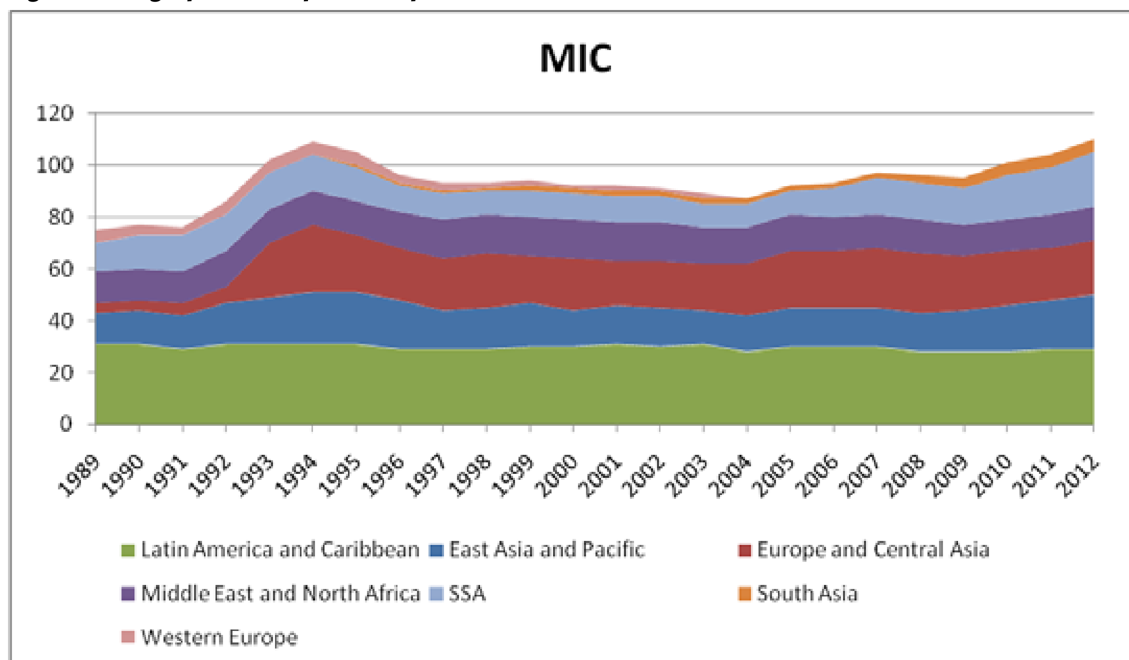
Over the following years, the number of LICs fell by nearly halve to 35 by 2012. Figure 1 further shows the geographical concentration of LICs over time. Overall, the amount of LICs is at a historical low level for every regional group. However, while in nearly all regions an appreciable number of countries have been graduating from the LIC-status (between 1 and 3 remaining per category[5]), there are still 29 LICs left in SSA.

The number of MICs underwent an inverse evolution: a stabilisation and a slight decrease during the nineties, from 109 in 1994, to 87 in 2004, and an increase during the last decade, up to 110 in 2012:

[4] Geographical classifications are based on World Bank classifications. The remaining countries were classified by the authors. SSA: Sub-Saharan Africa; EAP: East Asia & Pacific; SAS: South Asia; ECA: Europe & Central Asia; LAC: Latin America & Caribbean; MNA: Middle East and North Africa

[5] EAP: Cambodia, Korea, Laos, Myanmar and Solomon Islands; ECA: Kyrgyz Republic and Tajikistan; LAC: Haiti; MNA: no country left; SAS: Afghanistan, Bangladesh and Nepal.

Figure 2: Geographical composition of MICs



Source: authors' calculations based on World Bank Country and Lending groups FY 2012.

Overall, the figure illustrates an increase in the number of MICs, up to an all-time high of 110. Looking at the different geographical categories, SSA shows an important progress, from 10 a decade ago, up to 21 MICs today.

2.2 Other performance rankings and indicators

Although income-based classifications capture many elements of development, other useful indicators are available:

1. *State Fragility*

Fragile states [6] are not to be confused with LICs. The 2009 list of fragile and conflict-affected states (FCAS) of the DAC for instance contains in total 43 countries, including 26 of the 43 LICs, but also 16 LMICs and 1 HIC[7] (DAC, 2010). It is presented in table 1. As the list is a compilation of three lists of fragility, countries are marked in bold when they are common to all three lists:

Table 1: Fragile and Conflict Affected States (DAC)

Low-income countries **Afghanistan, Burundi, Central African Republic, Chad**, Comoros, **Democratic Republic of Congo, Eritrea**, Ethiopia, Gambia, **Guinea, Guinea-Bissau, Haiti,** Kenya, **Liberia**, Myanmar, Nepal, Niger, North Korea, Rwanda, **Sierra Leone**, **Somalia,** Tajikistan, **Togo**, Uganda, Republic of Yemen, **Zimbabwe**
Lower Middle-income countries **Angola**, Cameroon, Republic of Congo, **Côte d'Ivoire**, Djibouti, Iraq, Kiribati, Nigeria, Pakistan, Papua New Guinea, São Tomé and Principe, Solomon Islands, **Sudan**, Timor-Leste, Tonga, West Bank and Gaza
High-income countries Equatorial Guinea

Source: DAC, 2010

[6] Unless otherwise states, we use the list of fragile and conflict-affected states (FCAS) of the DAC, a compilation of three lists: The World Bank's CPIA list (≤3.2), the Brookings Index of State Weakness in the Developing World and the Carleston University Country Indicators for Foreign Policy.

[7] Based on 2008-data

Not all LICs are thus fragile (e.g. the Belgian partner countries Benin, Mali, Mozambique, Tanzania and Senegal are not), while many fragile countries are not-LIC (e.g. the Belgian partner West Bank and Gaza):

2. *Least Developed Countries*

The Least Developed Countries (LDCs) category was established by the UN in 1971. It preceded the human development index (HDI) in its effort to look beyond income per capita criteria. Although the HDI is conceptually better developed and annually available, the LDC categorisation is still being used (see e.g. the 2011 LDC-conference in Istanbul). In the upcoming debate, the classification will remain important, given the goal to halve the number of LDC from 48 today (see Istanbul Declaration in United Nations, 2011).

The criteria for LDCs are therefore (for the latest triennial review of 2009):

- **Extreme poverty**: low-income criterion, based on a three-year average estimate of the gross national income (GNI) per capita (under $905 for inclusion, above $ 1,086 for graduation);
- **A lack of human capital**: a composite Human Assets Index (HAI) based on indicators of: (a) nutrition: percentage of population undernourished; (b) health: mortality rate for children aged five years or under; (c) education: the gross secondary school enrolment ratio; and (d) adult literacy rate
- **Economic vulnerability**: a composite Economic Vulnerability Index (EVI) based on indicators of: (a) population size; (b) remoteness; (c) merchandise export concentration; (d) share of agriculture, forestry and fisheries in gross domestic product; (e) homelessness owing to natural disasters; (f) instability of agricultural production; and (g) instability of exports of goods and services.

Large economies are excluded by a limit on population size of 75 million. Currently, there are 48 LDCs: 33 African countries, 14 Asian and 1 Caribbean; or 30 of the 35 LICs, 17 LMICs and 1 HIC.

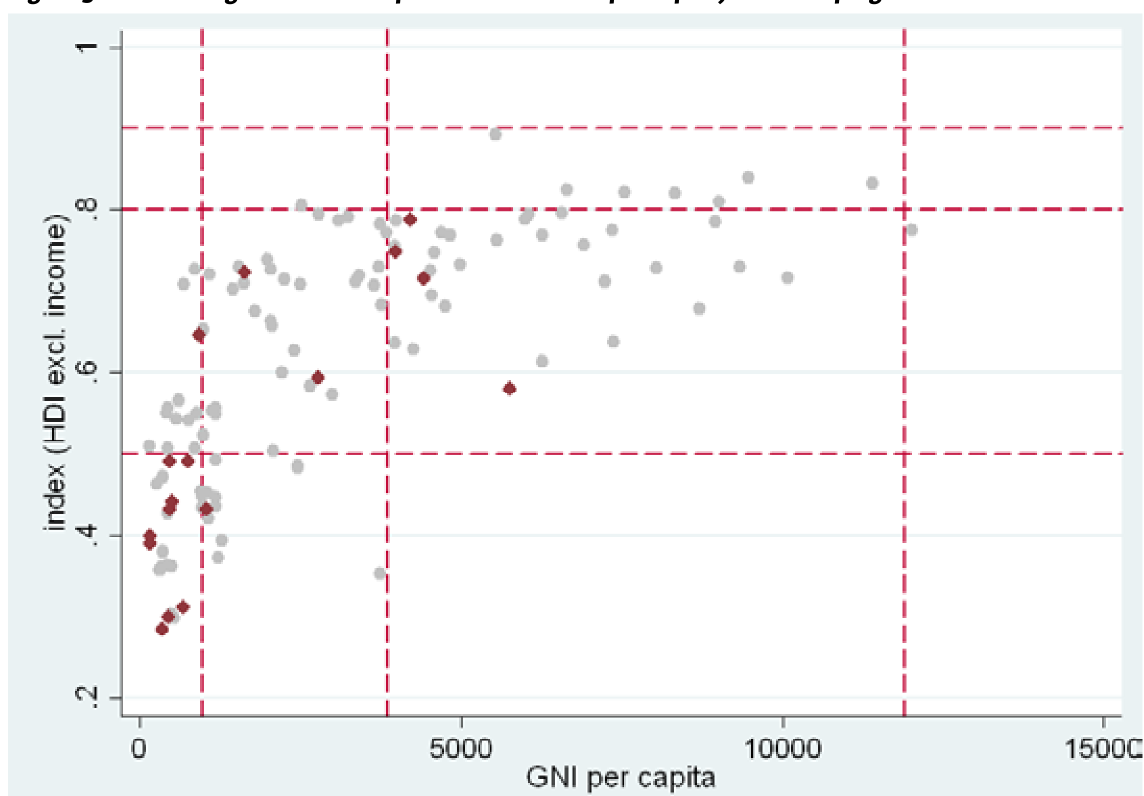
To qualify for graduation, a country must meet the thresholds for two of the three criteria in two consecutive triennial reviews. Since the LDC category was established, only three countries have graduated: Botswana in 1994, Cape Verde in 2007 and the Maldives in 2011. Given the fact that there are quite some middle income countries among the LDCs, and that it is the intention to halve the number of countries in the LDC list by 2020, names of potential candidates to graduate circulate, such has Equatorial Guinea, Angola, Samoa, Tuvalu and Vanuatu.

3. *Human Development*

In 1990, the UN established the human development index (HDI), a composite index of education, health and income measures.

To illustrate the difference between the HDI and income per capita, figure 3 below plots human development[8] against GNI per capita. The dotted lines mark the different income categories: LIC, LMIC, UMIC and HIC and the different human development levels: low, medium, high and very high. The graphs reveals that within the category of middle-income countries, there is considerable variation in per capita levels of human development.

Figure 3: Contrasting human development with income per capita, all developing countries



Source: authors' calculations based on World Development Indicators and Human Development Indicator

Figure 4 is comparable to figure 3, but only shows Belgian Partner countries:

[8] In order to avoid spurious autocorrelation, we limit the human development measure in our calculations to a weighted indicator of education (25% mean years of schooling and 25% expected years of schooling) and health (50% life expectancy at birth).

Figure 4: Contrasting human development with income per capita, Belgian partner countries

Source: authors' calculations based on World Development Indicators and Human Development Indicator

Senegal and Vietnam, two countries that reached MIC-status in 2011 and have a similar level of GNI per capita (Senegal 1,040, Vietnam 930), score very different on the other dimensions of the Human Development Index: Senegal 152th and Vietnam 109th, while MICs with similar HDI such as Bolivia (86th) and Ecuador (72th) have very different income levels (Bolivia: 1,630 and Ecuador: 3,970).

Table 2 below contrasts the two UN-categorisations: LDC and HDI.

Table 2: Constrasting LDC with

	Low HDI	Medium HDI	No HDI
LDC	Angola, Benin, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, DRC, Djibouti, Ethiopia, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Senegal, Sierra Leone, Sudan, Togo, Uganda, United Republic of Tanzania, Zambia, Afghanistan, Bangladesh, Myanmar, Nepal, Yemen, Haiti	Sao tome and Principe, Equatorial Guinea, Cambodia, Laos, Timor-Leste, Solomon Islands,	Eritrea, Somalia, Bhutan, Kiribati, Samoa, Tuvalu, Vanuatu,
Non-LDC	Zimbabwe, Côte d'Ivoire, Nigeria, Papua New Guinea, Cameroon, Ghana, Kenya	Republic of Congo, Pakistan, Swaziland, India, Cape Verde, Guatemala, Nicaragua, Morocco, Vietnam, Tajikistan, Syrian Arab Republic, South Africa, Kyrgyzstan, Indonesia, Maldives, Honduras, Namibia, Guyana, Micronesia, Uzbekistan, Egypt, Mongolia, Moldova, Botswana, Philippines, Paraguay, Bolivia, Suriname, Gabon, Thailand, Sri Lanka, El Salvador, China, Dominican Republic, Turkmenistan, Fiji	

Source: UN lists of LDCs (2009) and HDI (2010)

The fact that quite some LDC are medium HDI illustrates the discrepancy between the two UN concepts, and also suggests that these countries may well graduate from the LDC-category in the short future.

2.3DAC list of aid recipients

Historically, the OECD-DAC list of countries and territories eligible to receive ODA has not always been based on objective indicators of need or aid effectiveness. Instead, the list was negotiated and renegotiated among DAC members on the basis of a combination of geographical criteria and development criteria. Geopolitical considerations also played an important role. Israel for instance remained on the list until 1997, even if this was not justified by any objective development related indicator (e.g. at least since 1989 it has been a HIC in the World bank classification).

The list currently used by the DAC however is based on stricter set of criteria. The criteria are:

- All countries on the lists of least developed countries from the UN are included
- So are the low and middle income countries from the World Bank list
- Members of the G8 (Russia), EU (Bulgaria, Latvia, Lithuania, Poland and Romania), and countries with a firm date for entry into the EU are excluded
- A number of small island territories (Nauru, Niue, Tokelau, Wallis and Futuna, Anguilla, Cook Islands, Montserrat, Nauru, St-Helena) have been added.

To avoid regular reclassification of countries and acknowledging the difficulties of arbitrarily cutting off continuous variables, HICs are only excluded from the list once they have exceeded the HIC-income threshold for three consecutive years. For this reason, Equatorial Guinea (graduated FY 09), Oman (graduated FY 09), Trinidad and Tobago (graduated FY 08) and Barbados (graduated FY 08) are still in the current list that was made up in August 2009 and is used for flows of 2009 and 2010. Antigua, which is included in the list, was UMIC until FY 06, than graduated to HIC and became again UMIC from FY 11 onwards. Kosovo, although not yet included in the World Bank list, is classified as LMICs since FY 10.

2.4 Volatility of income classifications

Development is not necessarily an unbroken upward trend towards the status of high income country, at which point in time donor and partner countries establish a new relationship fully based on reciprocity. Although certain countries in East Asia have followed a consistent upward trend, many countries have a more chequered history:

Table 3: Income status transitions

Over the last 20 years 29 countries have fallen back from MIC to LIC status. Only 4 of those are still in the LIC status		
Movement	Number of countries	Examples
MIC to LIC without return	4	Korea, Dem. Rep; Kyrgyz Republic; Tajikistan; Zimbabwe
MIC to LIC to MIC	22	China, Indonesia, Egypt, Angola, Senegal, Nicaragua, Honduras, Bosnia and Herzegovina, Armenia, Equatorial Guinea (even HIC now)
MIC to LIC to MIC to LIC to MIC	2	Albania, Georgia
MIC to LIC to MIC to LIC to MIC to LIC to MIC	1	Solomon Islands

Source: Authors' calculations based on World Bank country classifications

Among the countries that graduated to MIC-status over the past decade, the majority had reached that income categoryonce before, but subsequently regressed to LIC-status (Glennie, 2011).

Besides those countries that effectively graduate and fall back, there are a number of countries that seem stuck around the LIC/MIC borderline, like for example Bolivia (LMIC since before 1989).

Development is thus more complex than one categorisation, based on income, and the assumption of uninterrupted progress once the MIC threshold is achieved, can capture. Some MICs face a high degree of fragility or show less progress in other development indicators, while some LICs might fare much better on these other indicators, showing much better future prospects for broad-based development.

Overall, the LIC/MIC graduation level is an arbitrary cut-off based on a single indicator of development. This is one of the reasons why donors often look at more development indicators (Sweden, for example on 20 indicators) to set up their country categories.

3 How do MICs differ from LICs?

MICs are a heterogeneous group. There are differences among them in their economic, political and social characteristics, and in the development challenges they face. Although diversified by their individual characteristics, there are nevertheless important dimensions in which they significantly differ as a group in comparison to LICs. In this section we focus on those mean differences that have implications for strategic donor decisions on aid volume and modalities.

3.1 Average personal consumption

The difference between LICs and MICs is clearly illustrated in table 4 where we present average personal consumption per capita per day[9]:

Table 4: GNI per capita, using PPP (2009)

Low income Countries	**2.61**		
Lower middle income countries	**6.55**		
Upper middle income countries	**21.13**		
Middle income countries	**9.77**		
Congo, Dem. Rep.	0.61	Senegal	4.12
Burundi	0.97	Vietnam	5.04
Niger	1.45	Morocco	6.87
Mozambique	2.03	Bolivia	7.68
Tanzania	2.31	Algeria	9.11
Uganda	2.48	Peru	14.24
Mali	2.51	Ecuador	15.31
Rwanda	2.51	South Africa	16.52
Benin	3.23		

Source: Authors' calculations based on World Development Indicators, World Bank

The table shows that on average household consumption in MICs is nearly four times larger than in LICs. Internal redistribution of all household income would in countries such as DRC and Burundi leave the whole population below the US$1.25 poverty line. This suggests that internal redistribution, however radical, only contributes marginally to combating poverty in those countries. Poverty reduction will have to rely on international redistribution and especially on higher rates of economic growth which has historically shown to be the effective strategy by far.

Before we proceed, it is important to ask whether the income measure of poverty (US$ 1.25) is a good proxy for measuring deprivation in non-income dimensions. The table below shows the global distribution of different poverty measures:

Table 5: Global Distribution of world's poor (percentage) by various measures, 2007-2008

	GNI per capita, per day <US$1.25	**Children out of school**	**Children below height**	**Children below weight**	**Multi-dimensional poverty Index**
MIC	72%	56%	71%	71%	70%
LIC	28%	39%	28%	28%	29%

Source: Sumner, 2010a

[9] Instead of GNI measured by using the World Bank Atlas Method, we use here the Purchasing Power Parity. This measure converts GNI to international dollars using purchasing power parity rates, and is a more adequate reflection of differences in living standards.

With the exception of children out of school, there is little difference between different poverty measures and the global poverty distribution generated. This suggests that poverty has broadly similar effects on manifestations of non-income deprivation in MICs and LICs.

Alonso et al. (2007 in Glennie, 2011) also find a clear relationship between higher income per capita and higher human development indicators. The only exceptions to this general rule are inequality and higher education, where there is no statistical difference between LICs and MICs.

3.2 Aid

Table 6 below illustrates how ODA is allocated over income categories:

Table 6: ODA received by income category (per capita and as % of GNI of recipient country), 2007-2009

	ODA per capita (US$)	ODA as % of GNI
LDCs	27.42	5.20
Other LICs	13.02	1.43
LMICs	6.29	0.26
UMICs	7.76	0.10

Source: Authors' calculations based on DAC Statistics

The table shows that ODA is relatively much less important for MICs compared to LDCs and remaining LICs. This gives donors less leverage in MICs, both collectively as well as individually, than they have in LICs.

Relatively less aid does not necessarily mean less fragmentation. On the basis of its Country Programmable Aid (CPA) measures[10], the DAC has calculated the fragmentation ratio on the basis of two tests, one from the perspective of the donor and one from the perspective of the recipient (DAC, 2009a):

1. Does the donor provide a higher percentage of this recipient's aid than it provides of total global aid?
2. Is the donor among the larger donors that together account for at least 90% of this recipient's aid?

Using these criteria, four types of aid relationship can be distinguished:

Table 7: Four types of aid relationships

	Yes to Question 1	No to question 1
Yes to Question 2	**A. Concentrated and important**	**C. Important**
No to question 2	**B. Concentrated**	**D. Non-significant**

Source: DAC, 2009a

[10] CPA is defined through exclusions, by subtracting from gross ODA aid that is unpredictable by nature (humanitarian aid and debt forgiveness and reorganisation), entails no cross-border flows (development research in donor country, promotion of development awareness, imputed student costs, refugees in donor country and administrative costs), does not form part of co-operation agreements between governments (food aid and aid extended by local governments in donor countries), is not country programmable by the donor (core funding to national NGOs and International NGOs), or is not susceptible for programming at country level (e.g. contributions to Public Private Partnerships, for some donors aid extended by other agencies than the main aid agency) (DAC, 2011). Although this measure gives a better estimate of the volume of resources transferred to developing countries, the flows it covers are not all imposing a burden on the limited administrative capacity of the recipient country.

Globally, 39% of donor-partner country relationships are non-significant, meaning that for each recipient country more than a third of its relationships with donors are non-significant. Looking at the difference by income groups, table 8 below shows that fragmentation is above average in MICs, mainly LMICs:

Table 8: Fragmentation ratio by income groups (based on DAC-data 2008)

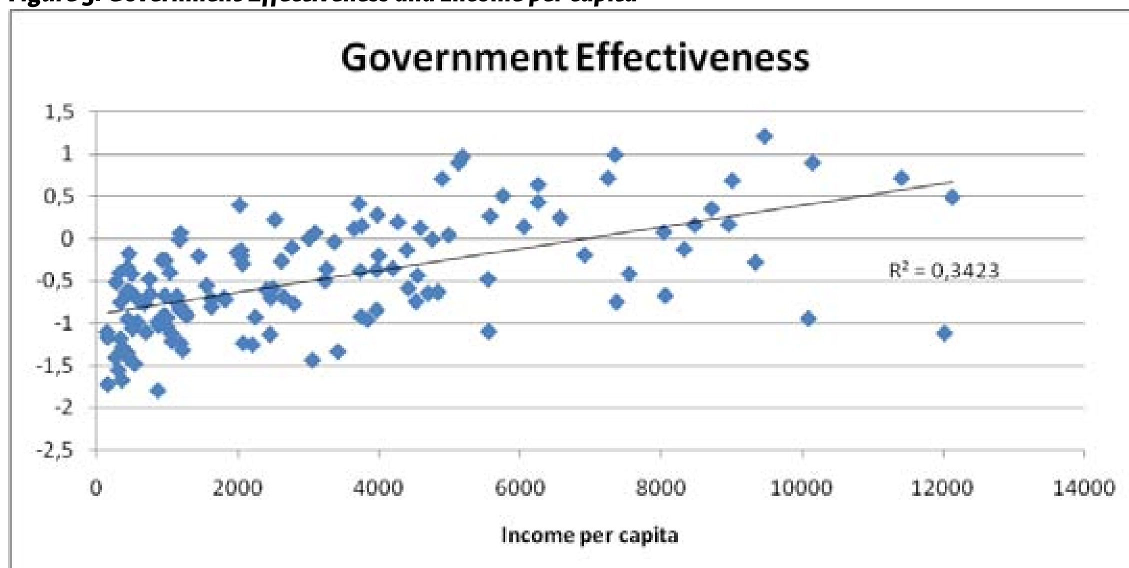
	Number of countries	All relation-ships	Donors in A	Donors in B	Donors in C	Donors in D	Fragmentation ratio = D/(A+B+C+D)
LICs	61	1,472	474	308	180	510	35%
LMICs	47	1,064	279	199	94	492	46%
UMICs	43	565	180	139	45	201	36%
Global	151	3,101	933	646	319	1,203	39%

Source: DAC, 2009a

3.3 Governance[11]

MICs may also differ from LICs in terms of quality of governance. A first such measure is the government effectiveness indicator calculated by Kaufmann et al. (2010). This indicator captures "perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies." It is a composite index made up on the basis of 16 aggregated indicators. The following figure illustrates the correlation between income per capita and government effectiveness:

Figure 5: Government Effectiveness and Income per capita [12]



Source: Authors' calculations based on Worldwide Governance Indicators, World Bank

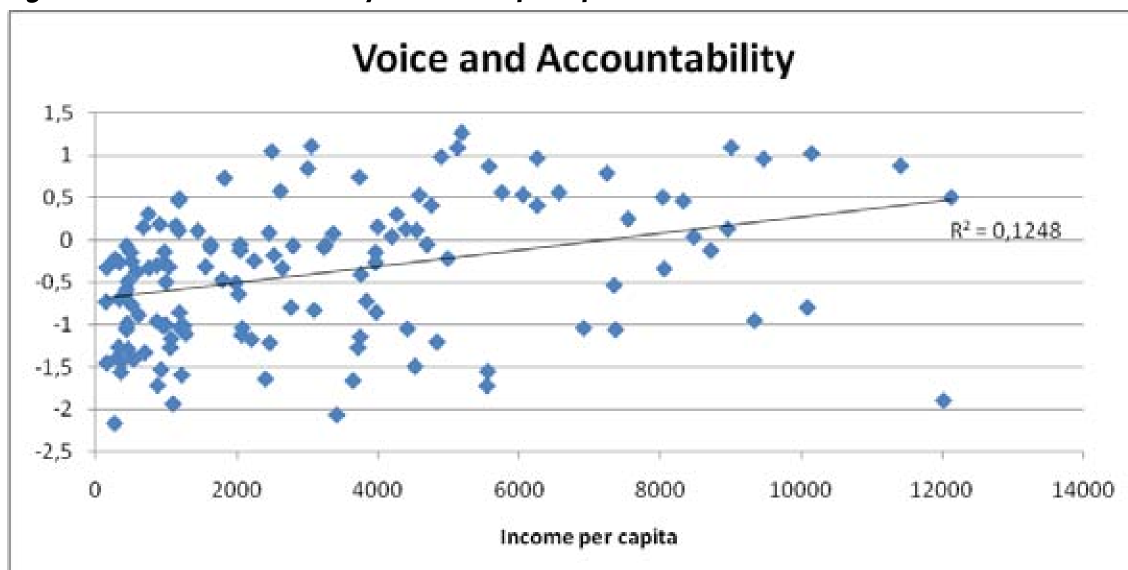
The graph shows a positive correlation between GNI per capita and government effectiveness. The average value of the index, which ranges from -2.5 to 2.5, is 0.73 higher for MICs than for LICs.

[11] We limit ourselves to two indicators that are most important from a donor viewpoint.

[12] R^2 measures to what extent values on the Y-axis are explained by values on the X-axis. It takes a value between 0 and 1. Applied to figure 5: about 34% of variation in government effectiveness is "explained" by variation in income per capita.

Another indicator, voice and accountability, is designed to reflect "perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and a free media." The figure below shows again a positive but weaker correlation between income and this governance indicator:

Figure 6: Voice and Accountability and Income per capita



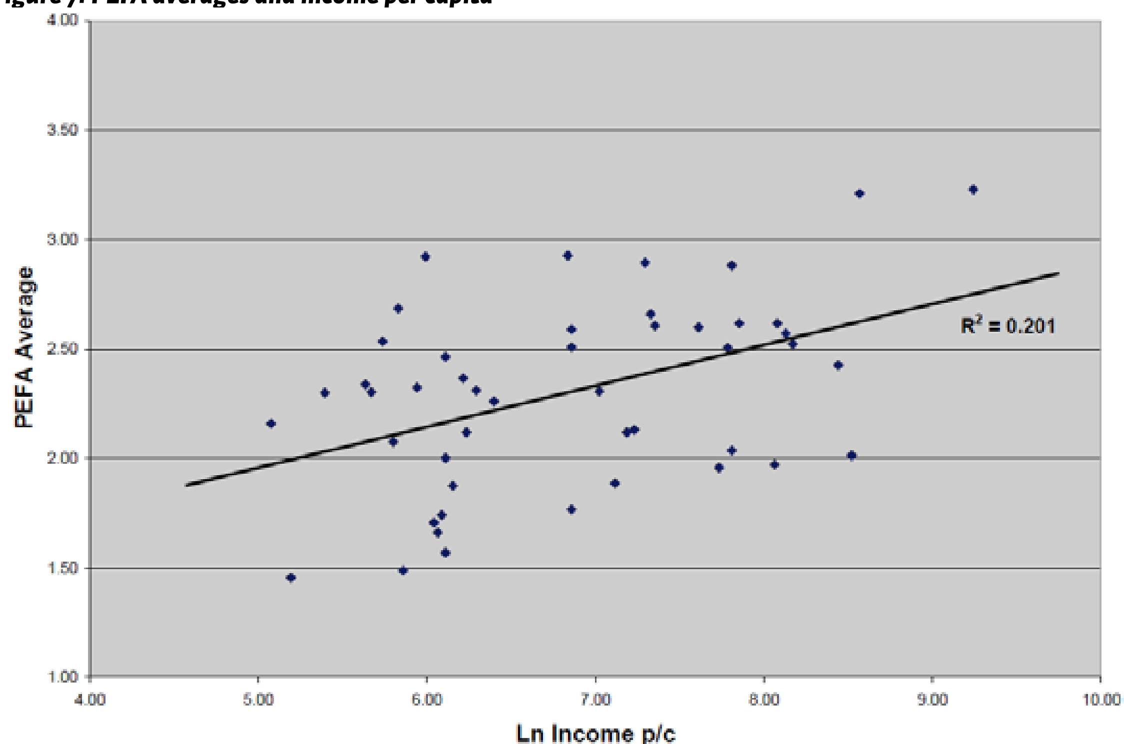
Source: Authors' calculations based on Worldwide Governance Indicators, World Bank

For MICs, the average value of this indicator, which also ranges from -2.5 to +2.5, is 0.59 point higher than for LICs.

3.4 Public Finance Management

On the basis of 56 PEFA assessments, Paolo de Renzio (2009) looked at the correlation between the quality of PFM systems[13] and the income per capita of the country. In line with the previous findings, the correlation is positive:

Figure 7: PEFA averages and income per capita



Source: de Renzio, 2009

The following table shows in more detail scores on the different PEFA-dimensions according to the World Bank income classifications[14]:

Table 9: Different PEFA dimensions and income per capita

	Overall	Income		
		LICs	LMICs	UMICs
Budget Credibility	2.7	2.4	2.9	3.0
Comprehensiveness and Transparency	2.5	2.3	2.6	3.1
Policy-Based Budgeting	2.5	2.4	2.5	2.3
Predictability and Control in Execution	2.2	2.0	2.3	2.8
Accounting and Reporting	2.2	2.0	2.2	3.1
External Scrutiny	1.9	1.8	2.0	2.5
OVERALL	2.3	2.1	2.4	2.8

Source: de Renzio, 2009

[13] To be able to compare PEFA assessments, that are given letters (A being best, D being worst), the letters were converted to numerical values: A=4,;B+=3,5;B=3;…;D=1.

[14] De Renzio uses the World Bank classifications of Financial Year 2008, using GNI per capita of 2006.

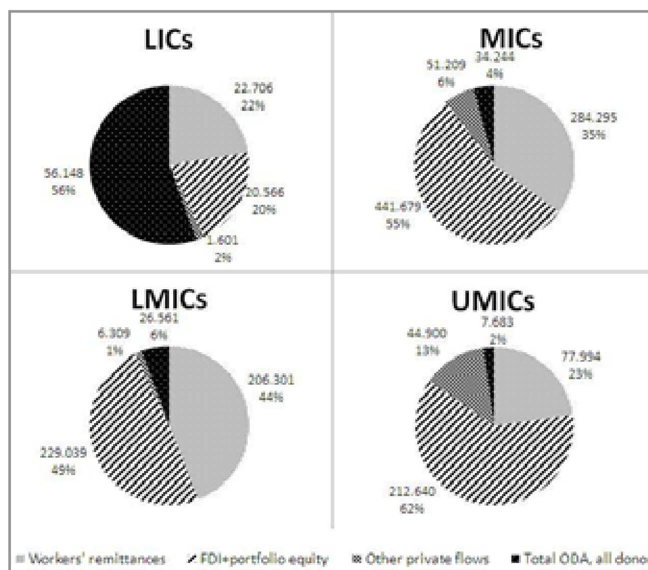
In line with correlation shown in the graph above, the table confirms that overall quality of PFM systems improves with income. Looking at the 6 different budget dimensions, we see that performance improves in line with income for all dimensions, except for policy-based budgeting, on which UMICs do even worse than LICs.

In contrast to the overall findings, we see in UMICs that the average scores do not tend to deteriorate the further one moves down the various phases of the budget cycle (or from top to bottom in table 9). De Renzio (2009) relates this to the growing focus on 'checks and balances' that is associated with higher levels of per capita income, or more simply with the fact that richer countries have more resources to devote to improving PFM systems.

3.5 Access to other financial flows

Over the past decades, official flows to developing countries have declined in comparison with private flows (Wood et al., 2011). The figure below illustrates the importance of a number of resource flows to LICs, MICs, LMICs and UMICs. The resource flows which have been selected are ODA flows; workers' remittances and compensations of employees; foreign direct investment (FDI) and portfolio equity flows; and other private medium-term and long-term flows, meaning bond investment and bank and other commercial lending.

Figure 8: Relative importance of selected net resource flows (2009, USD millions)

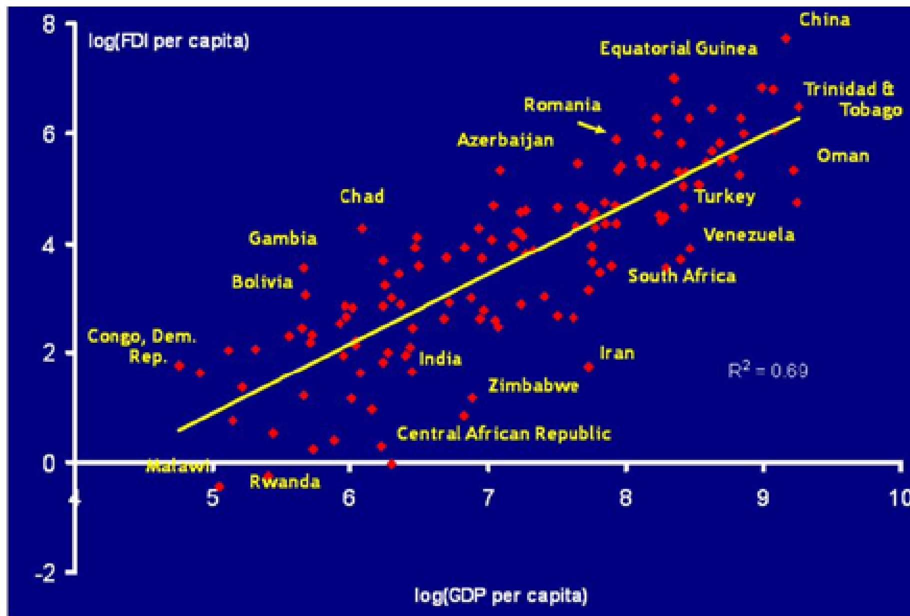


Source: Authors' calculations based on OECD-DAC statistics (aid flows) and the World Bank's Global Development Finance (GDF) database (other flows).

In the first quadrant, one can observe that for LICs, aid flows are the most important international resource flow. With rising income per capita, the other sources of external finance dramatically gain in importance. In LMICs, FDI, equity flows and worker remittances have overtaken aid flows as most important categories. The importance of FDI and portfolio equity further increases for the UMICs. In such a context, the reliance on aid is greatly reduced and aid should be used more selectively (Wood et al., 2011).

Although Wood et al. (2011) find that an average of 70% of global FDI to developing countries was concentrated in 10 MICs, figure 10 shows that there is a strong correlation between GDP and FDI per capita:

Figure 9: FDI and income per capita



Source: Dailami, 2008

4 Why give aid to MICs?

How much aid donors give to different countries and through which modalities depends on the publicly professed objectives of donor governments, but also on the other, non-development objectives they pursue, often by stealth, and on how private business interests, development NGOs, and other pressure groups are able to influence government agendas. From the late nineties onwards, the international community has exhibited a growing commitment to combat the major manifestations of poverty, especially in the fields of health and primary education, as illustrated by the 2000 Millennium Aid Consensus. This compact emerged after a decade of aid fatigue in the nineties and suggests that policy makers from the North had come to the understanding that the proper niche of aid, in comparison to other international financial flows, may lay in the fight against extreme poverty. In terms of geographical allocation of aid, this has translates in a donor discourse favouring the poorest and least developed countries.

Table 10: Disbursement of ODA by income group (Net disbursements, 1998-99 and 2008-09 average) [15]

Donor	ODA, net disbursement as % of total ODA											
	1998-99						2008-09					
	LDCs and other LICs			MICs			LDCs and other LICs			MICs		
	LDCs	Other LICs	Total	LMICs	UMICs	Total	LDCs	Other LICs	Total	LMICs	UMICs	Total
Ireland	64.8	7.2	72.0	21.2	6.8	28.0	68.2	11.3	79.5	14.0	6.5	20.5
Denmark	51.8	15.3	67.1	27.3	5.5	32.8	54.8	19.9	74.7	20.5	4.7	25.3
Canada	39.1	15.6	54.7	37.8	7.5	45.3	56.9	14.8	71.7	24.0	4.4	28.3
Norway	49.1	7.9	57.0	31.8	11.2	43.0	59.5	11.1	70.6	22.3	7.1	29.4
Nether-lands	42.1	10.9	53.0	37.5	9.4	46.9	54.5	13.0	67.5	24.6	7.8	32.4
Finland	42.8	10.8	53.6	38.9	7.4	46.3	53.8	13.1	66.9	24.4	8.7	33.1
Sweden	43.9	13.0	56.9	35.0	8.1	43.1	53.8	13.0	66.8	27.1	6.1	33.1
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
United Kingdom	39.6	14.3	53.9	34.8	11.2	46.0	49.7	15.9	65.6	27.2	7.2	34.4
Belgium	46.2	12.5	58.7	34.3	7.0	41.3	54.2	11.2	65.4	26.9	7.6	34.6
New Zealand	36.9	16.8	53.7	32.9	13.4	46.3	48.4	16.3	64.7	29.2	6.1	35.3
Switzer-land	42.5	10.7	53.2	35.8	10.9	46.7	47.5	14.8	62.3	31.9	5.8	37.7
Australia	26.5	36.5	63.0	30.6	6.4	37.0	35.1	24.5	59.6	37.6	2.9	40.4
Luxemburg	29.1	6.4	35.5	51.8	12.6	64.4	48.2	10.9	59.1	34.0	6.9	40.9
United States	30.4	11.3	41.7	56.7	1.6	68.3	43.4	13.2	56.6	36.6	6.8	43.4
Korea	33.8	17.7	51.5	46.7	1.8	48.5	36.9	17.1	54.0	40.0	6.0	46.0
Italy	47.6	10.5	58.1	36.7	5.2	41.9	42.2	9.5	51.7	37.1	11.3	48.4
Portugal	75.3	1.7	77.0	20.4	2.6	23.0	45.9	4.3	50.2	40.6	9.3	49.8
France	35.3	11.3	46.6	43.5	10.0	53.5	34.4	15.7	50.1	32.6	17.2	49.9
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
Spain	20.6	10.7	31.3	57.4	11.3	68.7	34.8	8.2	43.0	46.1	10.9	57.0
Greece	14.3	3.5	17.8	59.6	22.6	82.2	29.3	6.6	35.9	48.2	15.8	64.0
Austria	26.2	7.4	33.6	49.6	16.9	66.5	27.6	8.3	35.9	54.0	10.2	64.1
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**

Source: DAC, 2011

[15] Including imputed multilateral ODA and indirect cooperation and excluding amounts unspecified by country.

Data from the OECD-DAC presented in table 10 show that aid allocations have over the past decade become more focused on LDCs and other LICs, in line with the donor rhetoric. Between 1998-99 and 2008-09, the percentage of geographically allocated aid towards these countries increased from 45.2% to 57.8%, and this despite the fact that some important aid recipients like India shifted towards the MIC-status. Although aid towards MICs went down, it still stands at over 40%.

Looking at the evolution at donor level, we can see that on average donors spend 12.7% less in MICs than a decade ago. Japan has seen the largest reduction, nearly halving its aid to MICs from 66.3% to 33.9% in ten years, while Canada, Luxemburg, the United States, Norway and the Netherlands reduced their share of aid towards MICs by about one third. An opposite evolution is visible for Portugal that more than doubled its aid to MICs, presumably because it did not shift its geographical concentration away from its former colonies when some of then became MICs.

In 2008-09, Greece and Austria are the countries that distribute most of their ODA to MICs. In both cases this is due to the economic development in the regions on which they focus their development cooperation, namely Middle East, North Africa and Eastern Europe. Next in importance are Spain, Germany, France, Portugal and Italy, where MICs get halve of the aid or more. In these cases, historical ties are mostly at the origin of the bilateral relations with MICs. Belgium is in the upper half of the ranking, with some 35% of its ODA allocated to MICs.

Anderson et al. (2004) look to the relationship between poverty focus and aid to MICs in the EU and its Member States. They find that there is a positive correlation between the amount of net ODA received by MICs and different measures of poverty. The correlation is however rather low (0.20-0.26), indicating that poverty was only one factor in the choice of EU aid volumes to MICs, and certainly not the predominant one.

As a wider range of interests play in both receiving and giving aid to MICs, the reasons behind the transactions are more complex in MICs than LICs. From a development perspective, three normative arguments are advanced in the literature to justify aid to MICs:

1. Poverty reduction
2. Global public goods
3. Knowledge spillover effects

Besides these three major arguments, other arguments that are sometimes invoked include country vulnerability to slide back, historical relationships, accumulated country expertise, regional importance of MICs, or other aspects of bilateral relationships besides development cooperation, like commercial or political interests. All these have been proposed as additional reasons for setting up a bilateral aid relationship with MICs. In this section, we will consider the three most prominent reasons in more detail.

4.1 Poverty reduction

While it is generally assumed that aid should tackle poverty, operationalising this concept is not straightforward. Should poor countries or poor people be targeted?

As illustrated in the first section, the number of MICs has increased over the last decade. However, even with an average national average income well above the poverty line, there are many people in those countries who still have to live with less than $1.25. This, of course, has immediate consequences for the global distributions of poor people as shown in the following table.

Table 11: Distribution of poor (<1,25 US$) according to income category

		1988-1990	2007-2008
MICs	Total (101 countries)	7%	72%
	Fragile and Conflict Affected (FCAS, 16 countries, OECD)		11%
	Non-FCAS		61%
LICs	Total (43 countries)	93%	28%
	FCAS (26 countries)		12%
	Non-FCAS		16%
FCAS (43 countries)			23%
SSA		13%	27%

Source: Sumner, 2010a

By using the most recent poverty data (<1.25US$, 2007-2008 or nearest), the table shows in which countries the poor live. The LIC-MIC distinction used is based on the categories of World Bank FY 2010 that are based on data of 2008. Since then, in FY 2011, five more countries have graduated to MIC status (Senegal, Tuvalu, Uzbekistan, Vietnam and Yemen) and one fell back to LIC status (Solomon Islands). In FY 2012, Solomon Islands re-graduated, together with Ghana, Laos, Mauritania and Zambia. Using 2007-2008 poverty estimates, these countries have 54 million poor.

The table shows that the distribution of the world's poor has changed quite dramatically over the past two decades. While in the late eighties poverty was predominantly a problem of poor countries, and 93% of the poor lived in LICs, this assumption is no longer true today. In the late oughties, only 28% of the poor live in LICs (about 370 mn people) while 72% of the poor, or about one billion people, live in MICs. Paraphrasing but also challenging Paul Collier´s well-known book (Collier, 2008), Andy Sumner of IDS calls them the "new bottom billion".

The poor haven't massively moved across national borders of course. The change is mainly the result of countries in which many of the poor live getting richer and being reclassified. Several of the countries that graduated to MIC-status since 2000 contain huge populations, including large numbers of poor people. The most important ones have been referred to as the PICNIC group (Pakistan, India, China, Nigeria and Indonesia) (Sumner, 2010b). As a result of this about 707 million people 'moved' to the MIC-category.

A further breakdown in table 11 allows us to locate the poor according to country fragility. We see that 77% of the poor live in stable countries, 61 in MICs and 16% in LICs. Only

23% of the poor live in FCAS, split fairly evenly between fragile LICs and fragile MICs. No comparable data for the earlier period exist.

The next table shows the 10 countries with the largest numbers of poor people:

Table 12: Ten countries with highest poverty (below US$1.25, million, 2007-2008)

	LIC/ MIC	Fragile	Number of Poor
India	MIC	NO	456
China	MIC	NO	208
Nigeria	MIC	YES	89
Bangladesh	LIC	NO	76
Indonesia	MIC	NO	66
DRC	LIC	YES	36
Pakistan	MIC	YES	35
Tanzania	LIC	NO	30
Ethiopia	LIC	YES	29
Philippines	MIC	NO	20

Source: Kanbur and Sumner, 2011

Strikingly, of these ten countries, 6 are MICs and 6 are not fragile.

The pockets of poverty argument, that is often advanced for providing aid to MICs, rests on the moral principle that assistance is called for by poverty no matter where it occurs. It are the poor themselves who are fundamentally important, according to this argument, not where they live. The countries only matter indirectly, as an indicator of where the poor might live. Given the current distribution of poor across LICs and MICs and the present allocation of ODA, this argument calls for increased ODA levels to MICs at the expense of LICs.

In fact, if in addition to equity arguments, efficiency considerations are brought into the picture, it may be argued that ceteris paribus the poor in MICs should get more ODA per head than the poor in LICs. The argument has two versions. If donors use their aid to directly help the poor, for instance through conditional cash transfers, then the same dollar may bring more utility to the poor in a MIC. This is because the poor will increase their private expenditure, but in so doing will also be able to better enjoy local public goods such as transport, education, or drinking water, whose access is complimentary to private expenditure (Dasgupta and Kanbur, 2005). If donors use their aid to indirectly help the poor, by strengthening the provision of public goods by the government, such expenditures will have a higher return in countries with better public provisions, such as most MICs.

The above arguments are static however, and make abstraction of the prospects of the poor. Paul Collier argues that poverty should not be considered as just a set of circumstances defined by the here and now, but should be understood in a dynamic, forward-looking sense. The focus of aid should not be the poor in general, but the poor who do not have any prospects for escaping poverty, say, within one generation. On this count, the poor in India have much better prospects than the equally poor in the DRC. It is indeed difficult to imagine how India could keep growing at the high rates projected without a corresponding reduction in poverty, just as China did over the past decades (Collier in IDS, 2010).

This is the very definition that Collier proposes for the bottom billion countries: countries that do not provide their citizens a decent future. In his argument, the reasons are that such countries suffer from one or more of the following four development traps (Collier, 2008):

- The conflict trap.
- The natural resource trap.
- The landlocked with Bad Neighbours-trap.
- Bad Governance in a Small Country trap

The countries Collier lists are (Collier, 2009):

Table 13: The 58 Bottom Billion Countries according to Paul Collier

Collier's Bottom Billion		
LIC	MIC	HIC
Afghanistan, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, DR Congo, Eritrea, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Haiti, Kenya, Dem. Rem. Korea, Kyrgyz Republic, PDR Lao, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Sierra Leone, Somalia, Tajikistan, Tanzania, Togo, Uganda, Zambia, Zimbabwe.	Angola, Azerbaijan, Bhutan, Bolivia, Cameroon, Rep. Congo, Cote d'Ivoire, Djibouti, Guyana, Kazakhstan, Lesotho, Moldova, Mongolia, Nigeria, Senegal, Sudan, Turkmenistan, Uzbekistan, Yemen,	Equatorial Guinea

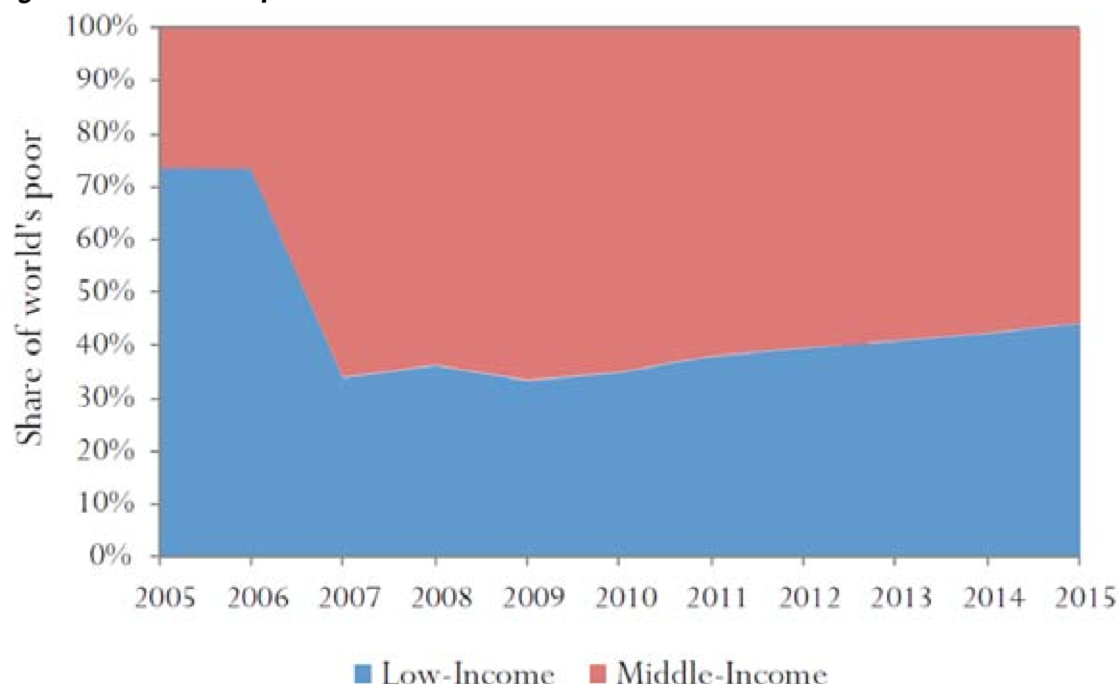
Source: Collier, 2009

What are the future prospects of poor in MICs and LICs to escape poverty? Of the three different ways to get out of poverty; national redistribution, international redistribution and economic growth, growth has historically been by far the most successful. Chandy and Gertz (2011) estimate that the number of poor in MICs is expected to fall at an average rate of 11.0% a year between 2005 and 2015 thanks to growth, compared to a rate of only 3.4% for LICs. This corresponds to halving the poor in 7 years for MICs, while it will take 22 years in LICs. Even if these are very approximate estimates, the order of magnitude suggests that poverty in MICs is something vast numbers of people are escaping from, in ways aid has never achieved. This makes strong intuitive sense given that many of the poor in MICs live in countries that are on a path of strong and sustained economic growth (Chandy and Gertz, 2011). These authors mention India and China, which together lifted a staggering 475 million people out of poverty over the last two decades and may well lift another 187 million out of poverty by 2015. In sharp contrast, on the basis of domestic economic prospects, poverty in LICs is likely to endure much longer, and the poor there have much less hope to escape from their predicament without external help.

Given the rapid changes in the worldwide distribution of poverty brought about by differentiated economic growth in different parts of the developing world, it makes good sense for donors contemplating changes in their geographic strategies to heed Collier´s advice and use a time frame stretching one or more decades. The same long term perspective is in addition warranted by the long lead time for aid strategies to be put in practice and to have an effect on the poor. Chandy and Gertz's (2011) project future trends up to 2015, and see a number of evolutions:

1. As fast growth in MICs lifts large number of people out of poverty, whereas nothing similar is expected to happen in many LICs, at least not on the same scale, the share of the world's poor residing in LICs is likely to rise gradually in the future from 33% in 2009 to 45% in 2015:

Figure 10: Distribution of the World's Poor Between LICs and MICs



Source: Chandy and Gertz, 2011

2. In line with this re-concentration of the poor in LICs, the geographical distribution of poverty is expected to shift towards SSA. As table 14 below illustrates, the poor were in the past mainly concentrated in three regions: East Asia, South Asia and Sub-Saharan Africa. Although SSA has registered important growth rates over the past decade, the growth in the Asian continent outpaces that of SSA. As a consequence SSA will be home to a growing share of the world's poor, more than halve of the world´s poor by 2015.

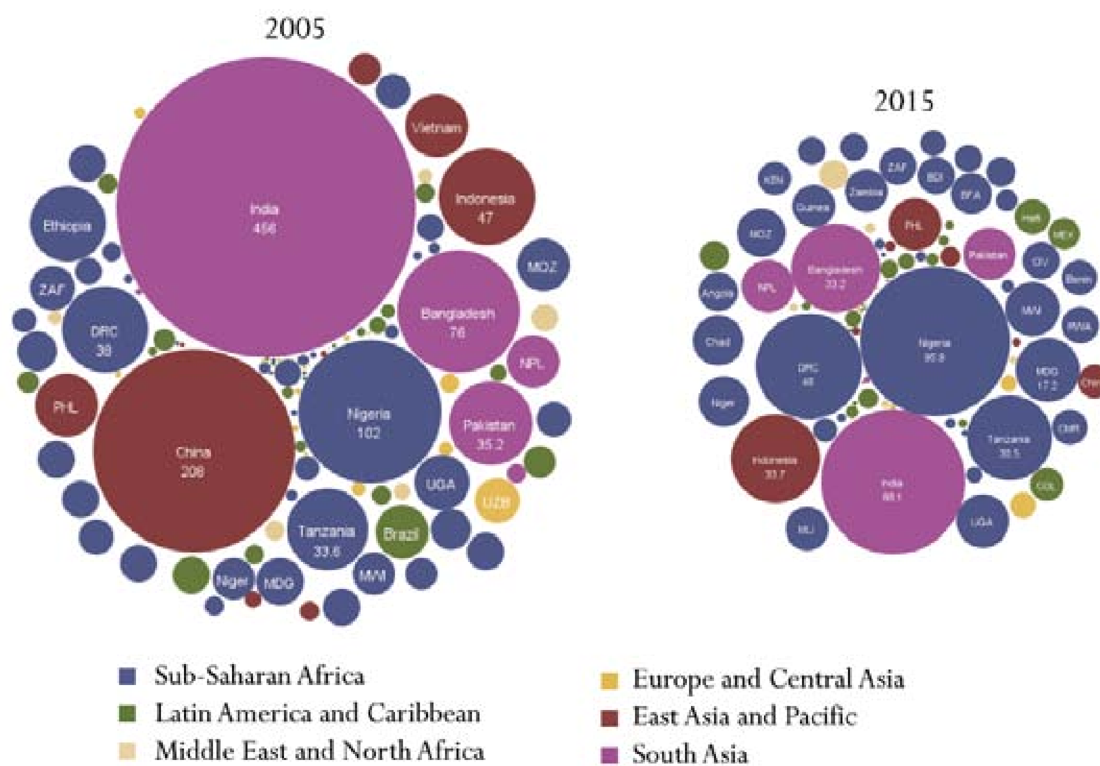
Table 14: Regional and Global Poverty (2005-2015)

	Number of poor					
	2005		**2010**		**2015**	
	Millions	**%**	**Millions**	**%**	**Millions**	**%**
East Asia	304.5	22.8%	140.4	16.0%	53.4	9.1%
Europe and Central Asia	16.0	1.2%	8.4	1.0%	4.3	0.7%
Latin America and Caribbean	45.0	3.4%	35.0	4.0%	27.3	4.7%
Middle East and North Africa	9.4	0.7%	6.7	0.8%	5.4	0.9%
South Asia	583.4	43.6%	317.9	36.2%	145.2	24.8%
Sub-Saharan Africa	379.5	28.4%	369.9	42.1%	349.9	59.8%
World	1,337.8		878.2		585.5	

Source: Chandy and Gertz, 2011

At country level, a similar evolution can be distilled:

Figure 11: The changing landscape of global poverty (2005-2015, millions of poor)



Source: Chandy and Gertz, 2011

While according to the visualisation presented in Chandy and Gertz (2011) and reproduced in figure 12, the landscape of poverty in 2005 was a colourful geographical mix, it is projected to be a largely African picture by 2015.

3. Finally, the estimates from Chandy and Gertz (2011) predict an increasing concentration of poor in countries that are fragile or failing[16]. Whereas only 20% of the world's poor lived in fragile states in 2005, the share is rising and is predicted to exceed 50% by 2014. While failed states were once assumed to be poor (see for example the LICUS category of the World Bank), this is no longer true today, challenging traditional donor intervention logics (The Economist, 2011b).

The plea to concentrate ODA on LICs, and particularly on LICs that are also fragile states, is not only that the poor there have much less prospect of being lifted out of poverty by economic growth. Another instrument, internal redistribution, is also less likely to be effective to help the poor, for the simple reason that there are not enough well-to-do people, from the middle class upwards, to tax. We have illustrated this with data on DRC and Burundi above. By contrast, in MICs, such possibilities do exist, and the richer the MIC, the more the argument applies[17].

[16] While in our own calculations we use the fragile and conflict-affected states (FCAS) classification of the DAC, these authors use the Failed States Index of the Fund for Peace, a continuous variable composed of 12 indicators (mounting demographic pressures, massive movements of refugees and IDPs, vengeance-seeking group grievance, chronic and sustained human flight, uneven development, poverty, sharp or severe economic decline, legitimacy of the state, progressive deterioration of public services, violation of human rights and rule of law, security apparatus, rise of factionalized elites, intervention of external actors).

[17] Politicians in donor countries opposing aid turn the same argument around. Why should our people pay taxes

The foregoing analysis does not lead to a simple formula for the optimal allocation of aid across MICs and LICs. On the one hand the moral argument that the poor should be helped wherever they live, LICs or MICs, is certainly valid. It is reinforced by an efficiency argument: a dollar of aid spent in a MIC, whether it is channelled directly to the poor or through the government, may well have a higher impact on poverty reduction compared to the same dollar spent in a LIC. But it is impossible to say in general how much higher that higher impact will be. On the other hand, the poor in fragile and underperforming LICs have much bleaker prospects than the poor in MICs. They are and will remain for quite some time more dependent on outside solidarity, because two other and generally more powerful instruments to help them, namely internal redistribution and economic growth, are not available. And such countries by and large have much less access to other sources of international finance. Whichever the optimal solution may be, it will certainly involve some aid being devoted to MICs.

4.2 Global Public Goods

A second argument that can be invoked to justify aid to MICs has to do with global public goods such as avoiding the spread of communicable diseases, containing climate change, controlling drug trafficking, improving security, or maintaining global financial stability. The argument is that the production of global public goods will be insufficient if left to the initiative of individual countries . This calls for appropriate initiatives for global action through such fora as the UN or the G-20. Equity considerations suggest that rich countries contribute a more than proportionate share to the funding of such global public goods that benefit both themselves and poorer nations. ODA is de facto one source of such funding[18]. The public goods argument of course applies with equal strength to LICs. In fact, as they are poorer than MICs, donor countries are expected to contribute even more on their behalf. But the global public goods argument suggests that MICs should not be excluded from aid flows. There are two reasons why some of ODA in support of global public goods will end up being spent in MICs. First, on the basis of the subsidiarity principle, global (regional) public goods are most appropriately addressed at global (regional) level through vertical, "single issue" programs, and many of these programmes intervene at country level. South Africa for instance is probably the country with the largest number of poverty stricken HIV/AIDS victims in the world, and thus also a suitable location to fight the disease and help the poor. As befits the definition of public goods, this will both help the victims, but, by containing the spread of the disease, will also benefit healthy people in the country and elsewhere in the world.

Second, some ODA may be channelled to MICs on the ground that it is indirectly instrumental to achieving development progress in LICs through international spillover effects. Assistance to MICs to reduce emissions of greenhouse gases (e.g. Brazil, India, China…) would, besides helping these MICs themselves, help the fight against poverty reduction in certain LICs that are heavily affected by climate change (e.g. Bangladesh). Or, if ODA could be instrumental in turning Nigeria and Ivory Coast into regional economic powerhouses, that would benefit a large number of LICs in that part of Africa. While the first argument focuses on poverty reduction

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to help the poor in some far away developing country, when the rich in that same developing country itself are not themselves being similarly taxed.

[18] We do not argue that ODA should become a source of funding for all major global public goods that have to be tackled, for instance climate change mitigation. What we argue is that, whether we like it or not, ODA is already, under present definitions, used to finance some global public goods, for instance the fight against HIV/AIDS, or dealing with the humanitarian the consequences of illegal migration

in MICs with spillovers to other countries, the second argument focuses predominantly on the spillover effects.

4.3 Knowledge Transfer

Countries that have successfully crossed the MIC-threshold may hold important lessons for countries trying to do the same. They may for instance have evolved effective bureaucratic procedures or introduced legislation or heterodox reform sequences that may be an inspiration for reform in LICs. Such South-South knowledge transfer is the third reason put forward for development cooperation with MICs.

A first way to realise knowledge transfers of this type is indirect, with donors cross-fertilising ideas across the countries they work in. In a world of incomplete information, donors, by engaging in MICs, gain useful knowledge that may not be otherwise available to LICs. This argument for continued aid to MICs is thus not directly linked to fighting poverty there, but to the fact that the knowledge gained by donors working in MICs, for example on social safety nets, is a source of knowledge for addressing poverty in LICs. This reasoning is often advanced by international agencies, and especially by the World Bank, which has experience in most developing countries of the world, and which prides itself as a the Knowledge Bank (see for example Kanbur and Sumner, 2011). Three assumptions underscore this argument. The first is that there are no alternative less costly ways for LICs to pick up good ideas from MICs. The second is that the knowledge gained in MICs is indeed transferable to LICs. The third has to do with the donor itself. Has the donor the necessary capacity to institutionally store useful knowledge in one country and then transfer it to another? While this may be the case for a large multilateral donor or a specialised vertical initiative or UN-agency, it is less likely to be so for a small bilateral donor.

A second way to realise the knowledge transfer is more direct, through trilateral cooperation. In this case, experts or policy makers from a MIC are brought in contact with their counterparts in a LIC, and appropriate capacity building is organised. Donors act as a facilitators and funders.

5 How give aid to MICs

The setting in which aid is negotiated, implemented and followed up in MICs differs from that of LICs. To start, as indicated before, MICs are typically much less aid dependent (lower ODA/GNI ratio), and as a consequence donor leverage through policy dialogue and conditionalities is limited. But then, if we are dealing with relatively successful MICs, public sector reforms, while undoubtedly still important, will be less of a precondition to development than in many LICs. A related point is that most MICs have better access to other sources of international finance than LICs, and the knowledge transfer component of ODA will then be more important than the finance itself. Finally, institutionally more competent countries will also suffer less from the transaction costs of traditional projects and of donor fragmentation. In any case, donors, because of their relative small contributions compared to the size of the economy and the public sector, will have to be more selective in the needs they decide to support (Wood et al., 2011).

For these reasons, the best way to deliver aid to MICs is likely to differ from best practices in LICs). There are important consequences for the prevailing donor discourse with respect to aid effectiveness. Some of the principles of the Paris Declaration (PD), designed mainly for countries with low levels of human development and a high degree of aid dependence, may not be particularly important in a MIC setting. In this section, we will go through the different principles of the Paris Declaration and analyse whether they are relevant in the average MIC. On the whole we not find the Paris Declaration principles very helpful for devising appropriate strategies for MICs.

Before proceeding further, we wish to repeat that the MIC category is a diverse group, and that specific country circumstances call for an implementation of more or less of the PD-principles. Bolivia, Romania, Dominican Republic, Morocco and the West Bank and Gaza, for example, were all MICs at the time they participated as a pilot country in the World Bank's Comprehensive Development Framework, an approach designed for PRSP countries and thus initially for HIPCs and later broadened to LICs. And Nicaragua, another MIC, hosted the Joint Country Learning Assessment of the DAC, which served as an input in the Paris Declaration.

5.1 Ownership

Given the higher management and administrative capacity of many MICs, national authorities will be better equipped to exercise leadership in the development and implementation of a national development strategy. They tend to have more ownership over their development agenda, more freedom of action and they take up a stronger bargaining position towards donors (Schultz, 2009; Wood et al., 2011).

Donors have limited direct influence over government policies, and programme-based aid modalities with elaborate dialogue structures between the government and the donors are less widespread. Sometimes donors achieve more by relying on indirect ways of influencing recipient national development strategies. Instead of trying to persuade governments through policy dialogue, they may be more influential by working through other stakeholders, such as parliaments, academia, the press, NGOs and other non-state actors, who, compared to their counterparts in LICs, tend to have higher capacities and sometimes (but not always) more voice to express their concerns. For this form of support, donors may also mobilise their own "indirect actors", such as NGOs, trade unions and academia.

5.2 Alignment

Alignment, as conceived by the DAC in the Paris Declaration, consists of three elements: policy alignment, system alignment and untying of aid.

5.2.1 *Policy Alignment*

An important argument in favour of policy alignment is that it is assumed that the recipient government is a development maximiser, or alternatively that it can be convinced by donor pressure to act like one. In MICs the latter is even more problematic than it is in aid-dependent LICs. Not surprisingly, MICs are not very concerned about setting up dialogue systems with donors (Wood et al., 2011). Reform incentives are more likely to come from the desire to attract FDI, regional economic integration and the like, than to please donors. The widespread poverty and high and sustained levels of inequality in many MICs further suggest that poverty reduction may not be as high on the government's priorities list, or that there are circumstances that prevent the government to put it high on its agenda. Given the fact that donors have less leverage to change recipient government policies, they will have to exercise sufficient selectivity to identify prevailing policies they can align with. The World Bank Task Force on MICs, for example, reported that one of the reasons why the Bank had become an unattractive partner for many MIC countries was the lack of World Bank alignment with country development priorities that were more oriented to growth and infrastructure investment than to poverty reduction and the achievement of the MDGs (Cabral et al., 2007). Similarly, in its MIC strategy, DFID notes that ideas about stability, growth and security might resonate better with MIC priorities and provide more common ground than with the classic donor concerns of poverty, exclusion and inequality (DFID, 2004).

5.2.2 *System alignment*

As illustrated before, MIC country systems are in general stronger than those of LICs, although there are important exceptions. In principle, this gives donors even less reasons to bypass government systems than they have in LICs. But the argument in favour of system alignment, in particular in the form of budget support, is more complex. LIC governments are crucially lacking in fiscal resources to provide public goods, whereas donors make large contributions compared to the government´s budget. This leads to a mutual dependence: the best way for donors to get results with their sizeable budgets is to work with and through governments, and the only way for cash strapped governments to realise their objectives is to work with donors. In MICs the assumption of resource scarcity and of mutual dependence in achieving objectives is harder to make. We would argue that in MICs the importance of aid does not lie so much in providing finance, or in leveraging much needed public sector reforms, as in the transfer of knowhow, and in the soft power of donor practices. It follows that project aid may well emerge as the most appropriate aid modality for these countries.. Of course, a choice for such lower modalities can and should be combined with the highest possible degree of system alignment and the avoidance of unnecessary parallel systems.

Because MICs have other sources of international and national finance, and because they are less dependent on aid as a share of GNI, it is not surprising to find that MICs are less concerned with the volatility of aid flows and predictability of disbursements (Wood et al. 2011). This is another factor that reduces the pressure on donors for explicit alignment exercises.

In cases of innovative and pilot approaches, learning and the dissemination of

knowledge are often key. Donor efforts to strengthen national M&E systems, among others by aligning their own M&E exercises, will be particularly appropriate.

5.2.3 *Tied aid*

The attempts of the DAC member states to untie aid have a longer history than the Paris Declaration itself. Different sets of concern are the basis of the quest to untie aid:

1. On the recipient side: the efficiency and effectiveness of aid.

Studies looking for effects of tying on recipient countries find that tied aid reduces the effectiveness and efficiency of aid through different channels (DAC, 2009b):

a. Direct costs: aid-financed goods and services sourced in the donor country may be consistently more expensive than those available to the recipient from alternative sources. The well-known study of Jepma (1991) arrives at an excess cost in the range of 15-30%. Later findings based on procurement prices under tied aid contracts, interviews with project managers and country-based examples largely reconfirm Jepma's conclusion and estimate an over-pricing of more than 20%, and even 40% or more for food aid.

b. Indirect costs: under the pressure of business interests in the donor country, donor agency and recipient government judgements get clouded, leading to the support for unprofitable economic projects, to excessive import content, to inappropriate technologies, emphasis on the wrong sectors, and the like. Arguably these indirect costs of aid tying are more important than the direct costs. Often they lead to complete failure of the investment projects that are supported

c. Debt worries: because tied aid is often partly financed with loans, recipient external debt sustainability is also an issue, especially in light of the previous point. Historically, a considerable part of the debt crisis in LICs that has been overcome at high cost through HIPC and MDRI initiatives, was caused by ill-considered donor lending to tied projects.

d. Finally, and also stressed in the Paris Declaration, tied aid undermines ownership.

2. On the donor side, several reasons have historically been put forward to defend tying practices. These do not, however, withstand the scrutiny of economic theory and by empirical evidence:

a. **The export competitiveness issue**. On the donor side, the primary intention of tying aid is to favour suppliers in the donor economy, relative to the rest of the world. Studies indicate however that the real impact of tying on donor exports is quite limited, but that these limited commercial benefits might be important for particular interest groups (DAC, 2009b). In fact, where aid flows are found to have a significant positive impact on exports, this is even more so as the proportion of untied aid increases with time, an effect known as the goodwill effect: as a result of untied aid flows, the recipient feels more inclined to buy goods and services directly from the donor (DAC, 2009b). In summary, aid tying bestows economic rents to powerful business lobbies at the expense of the collective interest of the donor country´s economy.

b. **Political support for aid**. A concern often voiced by those defending tying practices is that untying could result in a loss of domestic support for aid overall. The DAC evaluation of untied aid (Clay et al., 2008) does not find evidence to support these concerns. Another study (DAC, 2009b) even warns for the opposite effect, as the popular support for aid may be jeopardised following cases of aid malpractice. In the past a number of political scandals had an important impact on public support, policy making and aid untying in the UK (Pergau dam scandal in Malaysia) Norway (Ship Export Campaign). In Belgium a book on "white elephants" funded with aid money led to a public outcry, and to a reshuffling at the top of the aid Ministry (De Coninck, 1996).

c. **Effect on employmen**t. Finally, a number of studies analysed the effect of tying on the net increase in employment and found no positive effect (DAC, 2009b).

At the micro-level, the benefits of untying have been recently illustrated in the case of Afghanistan (Heady et al., 2011). On the basis of a survey undertaken in Kabul, the authors estimate that with the "Afghan First" approach, through which contracts are awarded to local registered Afghan enterprises, $441m in aid contracts created 118.000 jobs between 2006 and the end of March 2011. At the same time, since a business must be registered before it can bid on an international tender, these contracts are generating millions in badly needed local taxes (Gilmore, 2011).

Aid tying is a form of export protectionism, and like the more usual import protectionism, highly contagious. If one country starts tying it´s aid, others tend to follow suit. And if all countries act this way, then everyone loses. For the same supplier who gains a lucrative export market through tying of his national aid programme becomes in turn the victim of identical tying policies in other donor countries. The underlying collective action problem must be counteracted by international agreements to collectively untie aid. This is exactly the role that the DAC has performed over time, and with a good measure of success.

The definition of tied aid currently used dates back to the 1987 DAC Guiding Principles for Associated Financing and Tied and Partially Untied ODA (DAC, 1987). After a decade of voluntary, though not always consistent, reporting on the tying status of aid, the DAC members agreed in 2001 on a recommendation to untie most categories of aid to LDCs (DAC, 2001). The 2001 Recommendation excludes technical assistance and food aid and is not applicable to non-LDC MICs. In 2008 the coverage of the 2001 Recommendation was extended to non-LDC HIPCs[19]. The Paris Declaration refers to the 2001 Recommendation and includes a further qualitative commitment to make progress on untying aid. As a result of all this pressure, the degree of untying to both LDC and non-LDCs has increased between 1999-2001 and 2005-2007, from 57% to 83% for LDCs and from 49% to 70% for non-LDCs.

[19] These countries include the following MICs: Bolivia, Cameroon, Côte d'Ivoire, Honduras, Nicaragua and the Republic of Congo (and Ghana)

Given the selected coverage of the DAC Recommendation, it could be expected that untying would be selectively implemented in these countries covered by the recommendation. Table 15 shows that this is not necessarily the case:

Table 15: DAC donor countries: untied aid as percentage of donor ODA in 2007

Donor	Untied aid		
	as % of donor aid to all DCs	as % of donor aid to LDCs	as % of donor aid to non-LDCs
Luxemburg	100	100	100
UK	100	100	100
Norway	99,9	100	99,9
Switzerland	98,2	96,5	98,8
Australia	95,8	97,6	95,1
Ireland	95,1	100	89,2
Belgium	92,3	99,7	86,6
France	89,8	87,9	90,3
Denmark	87,6	94	83,5
Sweden	86,3	97	83,1
Finland	84,9	97,5	75,3
New Zealand	84,7	81,3	86,3
Netherlands	77,8	98,9	70,5
Austria	76,1	90	75,4
Japan	75,2	86,3	72,5
Germany	73,2	80,1	72
Canada	68,8	84,9	59,5
Spain	66,5	75,7	65,3
USA	62,9	74,8	58,5
Italy	52,2	52,5	52,2
Portugal	38,2	91,1	23,6
Greece	12,6	86,7	3,5
All donors (excl. EC)	76.0	86.0	72.8

Source: DAC, 2009b

For donors taken as a group we observe that aid to LDCs is relatively less tied. At the individual country level, this is however not necessarily the case. At the top of the ranking, we see that the frontrunners untie their aid to all developing countries. Further down the ranking however, we see that donors become more selective in the countries to which they untie their aid. The most extreme examples here are Greece and Portugal which largely untie their aid to the LDCs, in line with the DAC Recommendation, while leaving the rest of their aid largely tied. These countries thus apply the letter of the Recommendation, but do not follow the broader spirit.

5.3 Harmonisation

The Paris Declaration enumerates a number of commitments under the heading of harmonisation:

5.3.1 *Common arrangements and simplified procedures*

In those cases where policy alignment with the government is not considered appropriate, notwithstanding the fact that there is adequate government capacity, and therefore system alignment in itself would not pose a problem, it might be still worthwhile agreeing with other donors on common arrangements and simplified procedures for planning, funding, disbursement, monitoring, evaluating and reporting, so as to lessen the burden on the recipient government. It should however be assessed whether, given the higher capacity, the donor efforts required to coordinate and harmonise outweigh the potential benefits for the recipient (see e.g. DFID, 2004).

In countries and sectors where the ODA/GNI ratio is low, and where the provision of basic services does not depend on international financing, there are only limited incentives for MIC governments to develop elaborate programme-based approaches to manage and coordinate aid. The balance of potential benefits: greater control over external resources, simplification of procedures and the opportunity to link aid more directly to the development of ministry capacities, must be set against possible risks: more direct influence of the donor community, an increase in workload of ministry personnel, potentially less predictable financial resources. From their side, donors also need to judge, on a case-by-case basis, whether the benefits are worth the trouble.

That SWAps rather than full budget support might be a win-win-solution for donors and recipients is suggested by the SWAps that are implemented in Brazil, together with the MDBs. Brazil uses a SWAp to align MDB support to its programmes and systems (Cabral et al., 2007). Other MICs have less appetite for this sort of donor arrangements (Wood et al., 2011; DFID and AECI, 2004).

Coordinating missions to the field and sharing institutional or fiduciary assessments or monitoring exercises might be less pressing from the viewpoint of the recipient because of the higher capacity. From the perspective of the donor however, it may help to improve understanding of the country's context, create a common understanding across donors and harmonise dialogue with the partner country.

In MICs, there is often a fledgling capacity to supply high quality consultancy services, produced by local consultants, research institutions and academics. Such studies should be where possible commissioned locally, not only to reduce the high cost of studies carried out by donor country consultants, but also to boast local expertise, and to provide an incentive for further improvements in quality.

5.3.2 *Division of Labour*

International cross-country division of labour among donors might have an impact on MICs that is excessive. Indeed, if donors agree to reduce the number of partner countries, and set a minimum size for the ODA budget in any given country, they may well tend to throw out countries where they have relatively modest but effective aid programmes, especially if these are countries where aid is seen to be less crucial, in other words MICs. Not only might aid

decrease as a consequence of this evolution, it might also drain away more experienced donors.

At the national level, MICs have less appetite for elaborate arrangements for a formal division of labour among donors (Wood et al., 2011). Some however, e.g. South Africa, do take it up more strongly in their relation with donors. Their governments formulate more strongly the partners they prefer in their collaboration with donors.

5.3.3 *Internal harmonization*

Other domains of international cooperation that do not count as ODA may be just as important for developing countries as aid, if not more so. This argument applies to all developing countries, but with special force to MICs. Efforts to help MICs should therefore cover all policies affecting them. This means they should involve more than the main aid department or ministry, and endeavour to ensure consistency across departments. Besides external harmonisation with other donors, an internal harmonisation within the donor government is therefore called for to improve the development effectiveness of the totality of government policies towards MICs. The Centre for Global Development measures how rich countries government policies affect development in poorer countries with the Commitment to Development Index (CDI). This index is interesting in this regard, because it tries to assess donor consistency in this broad sense.

6 Donor Strategies

With poverty alleviation being the overarching objective for aid, it is generally assumed that aid will overwhelmingly flows towards the poorest countries. In many donor policies this is also the official rhetoric. Reality shows however that 42.2% of all ODA goes to MICs. Because of an official discourse that mainly emphasises poverty and the poorest countries, and because of the diversity among MICs, donors generally do not have a separate MIC strategy. In this first section we will look at a number of donor countries and the country classifications they use.

Before we look at the different donor countries studied, it is important to note that the country categories reflect:

- On the donor side: objectives pursued through aid, historical relations with particular countries, future goals of the cooperation…
- The characteristics of the recipient: poverty level, public sector capacity, government willingness, security situation, economic prospects, geographical location, strategic importance…

6.1 European Commission

In a speech given at the informal Council meeting of Development Ministers in Brussels, Commissioner Andris Piebalgs proposes country diversification as one of his six elements to increase the impact of EU development cooperation. Although the EU has to be engaged in all developing countries, "the specific nature and quality of the EU engagement will have to differ depending on the regional or country context" (Piebalgs, 2011). He suggests to differentiate cooperation based on four basic country categories:

1. The first category covers countries where financial aid is no longer the most relevant cooperation instrument. Common interests would not only allow for joint partnerships in trade, regional cooperation, migration and so on; it would also involve promotion of joint undertakings in addressing global challenges such as international security, global health and environmental protection.
2. A second category would comprise countries where the enabling conditions for inclusive growth (security, good governance and social inclusion) are met. In those countries EU could focus its resources on growth supporting sectors (energy, infrastructure, agriculture, aid for trade…) in close cooperation with the private sectors in the EU and partner countries alike.
3. In countries of category three the enabling conditions for inclusive growth are not yet met. Here EU support might focus on human development, notably health, education, social protection, and governance. At the same time there should be also support for economic growth and private sector development where possible.
4. A final category focuses on countries in situations of fragility. Here EU resources would have to focus on effectively linking security, governance and development.

6.2 Netherlands

The Dutch government introduced country profiles in its 2007 Policy Note "Our common concern, investing in development in a changing world" (Minbuza, 2007). The aim was

to acknowledge the differences between partner countries, to clarify the underlying choices and to better focus efforts. Country profiles were based on: (i) the main characteristics of and situation in the country, (ii) the policy effort the Netherlands intends to make and (iii) the specific needs of partners. Three country profiles were defined.

1. Accelerated achievement of MDGs.

Countries in this profile have a reasonable level of stability, improving governance, and are relatively dependent on aid. They are lagging behind in their contribution to the achievement of the MDGs, but could catch up if an extra effort is made in close cooperation with the government and other donors. In a number of countries, the actual or potential security problem is recognized, but it is not considered a dominant problem. The focus of cooperation will be on a Paris Declaration style (alignment, harmonization, DoL) cooperation.

Countries: Bangladesh, Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Kenia, Mali, Mongolia, Mozambique, Nicaragua, Rwanda, Senegal, Tanzania, Uganda, Yemen, Zambia.

2. Security and development

This profile applies to countries with a pressing security problem or sharp division in society that could potentially spill over into conflict. Because of this, these countries are generally unable to achieve the MDGs in the near future. Efforts will be geared towards the creation of the right conditions to take these countries closer to achieving the MDGs, with a focus on basic services. What concerns the Paris Declaration, focus will be on a minimisation of transaction costs.

Countries: Afghanistan, Burundi, Colombia, DRC, Guatemala, Kosovo, Pakistan, Palestinian Territories, Sudan.

3. Broad-based relationship

The last profile covers countries that are closest to the topic of this background study. It consists of partner countries that enjoy solid economic growth, are making progress on the MDGs and have already achieved MIC-status or are likely to do so in the foreseeable future. As a consequence, these countries are evolving towards a broader range of relationships and developing cooperation no longer lies at the core of bilateral relations. The Dutch development partnership will be scaled back and succeeded by other types of bilateral relationships. Three focuses are listed for cooperation with these countries:

- Broadening: Areas flanking development, including economic, political, cultural relations as well as climate policy and security will be targeted to ensure that development is broadened
- Specific interventions aimed at achieving the MDGs: Generally, a multilateral channel or an international partner might be the preferred option for this purpose.
- Uncertainty and institutional weaknesses: Generally, these countries will take more leadership over their development process, limiting the possible interference of donors. Two risks should however be taken in consideration when set-

ting up a development programme: (i) the uncertainty whether the economy and prosperity will continue to grow and (ii) institutional weaknesses that are not necessarily solved with economic growth.

Countries: Egypt, Georgia, Indonesia, Moldova, Vietnam, South Africa, Suriname.

Following the 2010 elections and the Scientific Council Report "Less pretention, more ambition: a Dutch cooperation that will make a difference", the new Dutch government is currently in the process of reducing the number of partner countries from 33 to 15 (van Lieshout et al., 2010; Minbuza, 2011).

The process started with all 33 embassies being asked to explain how and if the four sector priorities (peace and security, water and sanitation, food security, and sexual reproduction) could be implemented in the country in which they work. After an assessment of the answer 18 countries were excluded as partner country.

In the selection, the three UMICs (South Africa, Suriname and Colombia) were excluded and only 5 (Ghana, Yemen, Palestinian Territories, Sudan and Indonesia) of the 17 LMICs were retained. Although this selection was not always based on strictly objective criteria, and political considerations certainly played a role, a criterion that was used and made a difference was the capacity of countries to generate their own income through taxes.

The three profiles listed above will remain, but a number of countries have been rescheduled:

Profile 1: Benin, Ethiopia, Mali, Mozambique, Rwanda and Uganda

Profile 2: Afghanistan, Burundi, Palestinian Territories, Sudan and Yemen

Profile 3 : Bangladesh, Ghana, Indonesia and Kenya

For 15 countries[20] an exit strategy will be prepared and for another 3 that were in the third category (Colombia, Vietnam and South-Africa) a new transition-facility will be set up in collaboration with the Ministry of Economic Affairs, Agriculture and Innovation. This facility will be "a country specific instrument for (nearly)-MICs to facilitate the transition from a bilateral development relation to an economic cooperation with mutual benefits. This facility is therefore directed towards improving the investment climate in sectors with opportunities for Dutch companies." The facility is planned to be temporary, two years. At the end of September 2011, the Dutch minister will provide more information to parliament (Vice Versa, 2011)

6.3 DFID

DFID recently carried out a bilateral aid review. As a result, aid will be focused on less countries. While in 2008/09 140 countries received some form of UK bilateral aid, there were only 43 countries with significant bilateral aid programs. The review reduced this number to 27, and mainly MICs were dropped (DFID, 2011).

Prior to the review, the Minister announced that aid to China and Russia would be stopped. The remaining countries were considered in terms of (i) development need, (ii) the likely effectiveness of assistance and (iii) strategic fit with UK government priorities. The first two considerations were brought together in a needs-effectiveness score. In this approach, the 'need' component is based on the Human Development Index (inverted), a measure of the coun-

[20] Bolivia, Burkina Faso, DRC, Egypt, Georgia, Guatemala, Kosovo, Moldova, Mongolia, Nicaragua, Pakistan, Senegal, Suriname, Tanzania and Zambia.

try's fragility (Country Indicator for Foreign Policy – Failed and Fragile States Indicator (CIFP)) and the number of people living under $2 a day. The effectiveness component is based on the CPIA:

$$\text{HDI*CIFP-FFS*Population living under \$2 a day}^{0.2}\text{*CPIA}$$

As a result of these three considerations, 16 of the 43 countries are being dropped: 4 out of 22 LICs, 9 out of 17 LMICs and 3 out of 4 UMICs. Of the remaining countries, 19 are in the upper quartile when ranked according to the needs-effectiveness score (India, Nigeria, Ethiopia, Bangladesh, Pakistan, Uganda, DRC, Afghanistan, Tanzania, Kenya, Mozambique, Rwanda, Myanmar, Sierra Leone, Yemen, Ghana, Sudan, Malawi and Zambia) and 2 were in the second quartile (Nepal and Liberia). The remaining 6 countries (Tajikistan, Kyrgyzstan, Zimbabwe, the Occupied Palestinian Territories, Somalia and South Africa) are kept because the Minister believes that DFID can make a significant impact.

In MICs from which Britain withdraws, a high rate economic growth is apparently an important consideration, suggesting that aid programmes are no longer required (e.g. Vietnam). In LICs, limited British comparative advantage (Niger and the Gambia) or limited absorptive capacity (Burundi) are put forward.

6.4 Germany

Since the unification of both Germanies the German Ministry for Economic Cooperation and Development (BMZ) has repeatedly reduced the number of partner countries. During one of these concentration efforts, MICs and small-islands states were dropped. The most recent major change took place with the 2009 change of government. With this review a reduction to 50 partner countries was aimed using 5 criteria (Meyer, 2011):

- Good governance and development orientation (Bertelsmann Transformation Index...)
- Needs (HDI, % of absolute poor...)
- Significance of German support (CPA, division of Labour...)
- Sources of risk (failed states...)
- Strategic partnerships (Global Public Goods)

In contrast to DFID, BMZ does not aggregate these criteria in a composite index/ quantitative ranking.

Besides a review of the list of partner countries, the new coalition agreement also foresaw a review of German cooperation with larger emerging economies. Different demands are raised by emerging countries who are now major users of natural resources, new donors, increasingly important trading partners, but still are home to a majority of the world´s poor. At the same time, other German Ministries engage with the larger MICs. The German government considers it important to continue engagement in the larger emerging economies to achieve international commitments (e.g. MDGs), shared economic and political goals, support sustainable development and to transfer technological solutions and know-how.

For cooperation with these emerging economies, BMZ, in collaboration with the German Development Institute (DIE), developed in 2004 the concept of "anchor countries". With this concept, BMZ looks beyond GDP per capita, taking into account the roles that more

powerful countries might play, both positive and negative, in relation to other countries in their region (Harris et al., 2009). The criteria for selecting those countries are (Meyer, 2011):

- Ability to play creative role in "global governance" (e.g. G20),
- Relevance for achieving the international MDGs
- Size of national economy is of global relevance
- Key role in regional integration processes/cooperation.

Although DIE listed 15 potential candidates, the 2004 Anchor Country Strategy was initially limited to nine countries (China, India, Indonesia, Pakistan, Egypt, Nigeria, South Africa, Brazil and Mexico)[21] .

Cooperation with these countries will focus on two aspects: (i) cooperation in the countries through bilateral programs and projects, and (ii) supra-national cooperation with emerging economies as part of shaping regional and global development agendas. Finally, the partnerships with anchor countries create a need to develop specific cooperation instruments :

- Financing needs become less relevant; need for adapted financing instruments (credit, composite financing)
- Capacity building, further education/vocational training, (integrated) experts, paid TA/consultancies
- Dialogue programmes that transcend national borders, international exchange of experience and networking
- Triangular cooperation
- "Emerging Economies Fund" funded from repayments of loans granted to emerging economies and that could be used for further cooperation with MICs.

6.5 Sweden

In Sweden, country categories were introduced in 2007, together with a reduction in partner countries to increase aid effectiveness (Ministry of Foreign Affairs Sweden, 2007b).

In a first phase, the amount of partner countries was reduced based on an analysis of 20 indicators. Four questions were central in this analysis:

1. How extensive is poverty and where are the needs greatest?
2. What expectations can we have regarding the effectiveness of our aid?
3. Is democratic development going in the right direction and do we have the potential to influence it?
4. How can Sweden help?

The overall outcome of this process was a stronger focus on Africa, Europe, peace and security and democracy and human rights.

Countries that were considered as regular partner countries were divided into three categories:

1. Countries with which Sweden will conduct long-term development cooperation focused on poverty reduction.

[21] The following countries listed by DIE did not make it to the list: Turkey, Thailand, Argentina, Russia, Iran, and Saudi Arabia.

Countries: Bangladesh, Bolivia, Burkina Faso, Cambodia, Ethiopia, Kenya, Mali, Mozambique, Rwanda, Tanzania, Uganda and Zambia.

2. Countries in conflict and/or post-conflict situations with which Sweden will conduct cooperation focused on peace and security. This will require special and flexible measures.

Countries: Afghanistan, Burundi, Colombia, DRC, Guatemala, Iraq, Liberia, Sierra Leone, Timor-Leste, Somalia, Sudan and West Bank and Gaza,

3. Countries in Eastern Europe with which Sweden will conduct reform cooperation to facilitate EU integration.

Countries: Albania, Bosnia and Herzegovina, Georgia, Kosovo, Former Yugoslav Republic of Macedonia, Moldova, Serbia, Turkey, Ukraine.

Beyond these partner countries, Sweden listed a number of countries where other forms of cooperation will be implemented

4. Countries where regular state-to-state cooperation is not possible or desirable, but in which Sweden will conduct alternative measures to promote democracy and human rights.

5. Countries where Swedish development cooperation will be phased out, but in which Sweden will conduct selective cooperation to ensure that Swedish involvement can take new forms.

Countries: Botswana, China, India, Indonesia, Namibia, South Africa, Vietnam.

6. Countries to be phased out but where relations will be promoted in other ways than through bilateral development cooperation.

6.6 Specific aid instruments

Only in Sweden could we find a specific aid instrument which is mainly targeted towards MICs: Partner Driven Cooperation (PDC) (Ministry of Foreign Affairs Sweden, 2007a). For countries of category 5, it should make up the bulk of cooperation.

With PDC, Sweden tries to set up self-supporting relationships between Swedish actors and actors in low and medium income countries. In this way, PDC should form a bridge in the transition from long-term development cooperation towards strengthened and deepened bilateral relations once development cooperation is phased out. PDC can be conducted in various areas and relates to various types of cooperation: cultural, economic, research, institutional, local government and regional, and between CSOs. The targeted Swedish actors are companies, government agencies, universities and higher education institutions, and trade unions.

Aid is intended to act as a catalyst and is temporary, limited to three years. After that time, the relationship should be able to live on without financial support from the development cooperation budget.

An example of a programme that might become a successful form of PDC is DemoEnvironment (Danielson, 2010). In this programme, companies, government agencies, municipalities and institutions apply for funding for demonstration projects and feasibility studies in the areas of sustainable urban development and renewable energy. The idea is that these funds should be able to function as a catalyst and that the projects would be financed over time through other sources, often commercial.

7 Conclusions

In 2011, 61% of the world´s poor live in non-fragile MICs (table 11). This suggests that the 42.2% of ODA bilateral DAC donors devoted to such countries in 2008-2009 (table 10) is not excessive, even if the only objective is poverty alleviation. On the contrary, apart from the fact that many poor people live there, the effectiveness of aid in such countries may well be higher. A powerful counterargument is associated with Paul Collier´s thesis about the Bottom Billion, a billion people living in countries without any prospect for escaping poverty within one generation. His argument can be interpreted as a plea in favour of channelling almost all ODA to a set of underperforming countries, most of which happen to be LICs (table 13). The argument in favour of aid to MICs is also static. As explained, the dynamics of growth are such that the present distribution of the poor is rapidly and significantly shifting towards LICs, and in particular towards SSA LICs. According to some estimates, by 2015 almost 60% of the world poor will live in SSA (table 14).

Apart from the poverty argument, two other, mutually related, arguments have been made in the literature in favour of MICs: global public goods and knowledge transfers. Again, these are general arguments, and it must be shown whether they apply to given donors and recipient countries.

We have expressed some reservations about the appropriateness of some aspects of the Paris Declaration. The Paris Declaration was inspired by a different set of countries and problems: countries that have weak public sectors, are highly aid dependent, and cannot afford to ignore donor advice. In devising an appropriate mix of instruments for MICs, the discourse that has emerged around the Paris Declaration can be quite misleading. Particularly the emphasis on higher aid modalities and associated technical assistance and policy dialogue is unconvincing. We would guess that in many MICs projects (preferably "new style projects" that are as aligned as possible to partner country systems) and SWAps are appropriate, whereas sector or general budget support much less so.

A number of the donors whose MIC strategies are summarised above see ODA to MICs as a stepping stone to a post-aid, fully reciprocal relationship. For this reason they move to less concessional financial instruments, and bring in the private sector. Among several challenges, two stand out. First this step must be taken without falling in the trap of aid tying. The literature that was summarised above does not contain any convincing argument that aid tying is a constructive way of preparing a more mature reciprocal future relationship with MICs. In fact, tying almost inevitably leads to donor private business lobbies receiving economic rents in ways that are harmful to the economic interests of the recipient country. The second challenge is that such aid must be temporary. Some donors set a fairly short time limit on the activities they sponsor with such transitional aid in MICs. But it is far from evident how ODA may constitute seed money for future transactions that will have no element of subsidy attached to them.

In aid to MICs, some of the more thoughtful donors try to bring in other Ministries and universities. The argument extends to CSOs. This makes sense, inasmuch as the importance of the financial transfer in ODA diminishes and the importance of the transfer of knowledge increases. It also opens up new perspectives for the collaboration with universities and NGOs. In this context the idea of "extensive" rather than "intensive" complementarity between direct and indirect actors is relevant.

Finally, it is good to recall that he concept of MICs covers a large group of countries that share an income per capita above a certain threshold but that are otherwise very different from each other. In the donor documents that we could consult refined profiles are being proposed that go beyond the distinction between LICs and MICs. In fact, none of the donors we studies relied solely, or even primarily, on this particular characteristic of recipient countries in formulating their country strategies.

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