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Why and how to aid 'Middle Income Countries'

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Summary

The amount of aid that flows to 'Middle Income Countries' (MICs) has recently been challenged and some donors are shifting the balance of their aid so that more goes to poorer countries. Is there still a role for aid to MICs and what should that role be? Drawing on cases from the Andean region and Jamaica, this paper seeks to contribute to that debate within the current context of the Millennium Aid Consensus and the new ways of working that include greater emphasis on country ownership and programmatic and budget support. It concludes that, as aid as a proportion of GDP is usually modest in MICs, donors have little direct leverage. Necessarily the role of aid must be to support the agenda of those local actors, government or otherwise, who are working for the kind of change that a donor judges worthwhile.

If a 'Middle Income Country' has a track record of rapid improvement in the welfare of its population, aid may primarily be justified to speed things up. Conversely, if no or little progress is being made, aid may be justified because of the very lack of progress in poverty reduction that may be due to deep structural inequalities and exclusion of much of the population. In this latter case it is suggested that great care should be taken to ensure that commercial and political interests of the donor government do not undermine the aid effort.

Good aid practice also needs to take account of the diversity among MICs, bearing in mind that the classification system is very arbitrary, not locally owned and not integrated into regional or sub-regional considerations and history. The paper concludes by questioning some of the current conventional assumptions about the cost and benefits of donor coherence and coordination.

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Preface

Rosalind Eyben and Stephen Lister were commissioned to write this paper by the British and Spanish aid agencies (Department for International Development (DFID) and Spanish Agency for International Cooperation (*Agencia Española de Cooperación Internacional)* (AECI)) with a contribution from Iliana Olivié. An earlier version was used as a background document to inform AECI/DFID visits to Bolivia, Colombia, Peru and Jamaica by Ben Dickinson, Luis Tejada and Iliana Olivié. This published version incorporates findings from those visits. The views expressed in this publication are not necessarily those of DFID or of the AECI.

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Acronyms

AECI	Spanish Agency for International Cooperation (*Agencia Española de Cooperación Internacional)*
AfDB	African Development Bank
AsDB	Asian Development Bank
CAF	Corporación Andina de Fomento [Andean Development Fund]
CDF	Comprehensive Development Framework
CIDA	Canadian International Development Agency
CSO	Civil Society Organisation
DAC	(OECD) Development Assistance Committee
DFID	Department for International Development
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECLAC	Economic Commission for Latin America and the Caribbean
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union
FDI	Foreign Direct Investment
FSU	Former Soviet Union
GNI	Gross National Income
GNP	Gross National Product
HDI	Human Development Index
HIC	High Income Country
HIPC	Highly Indebted Poor Country
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFA	International Financial Architecture
IFI	International Financial Institution
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
LAC	Latin America and Caribbean
LDC	Least Developed Country
LIC	Low Income Country
LICUS	Low Income Country Under Stress

LMIC	Lower Middle-Income Country
MDB	Multilateral Development Bank
MDG	Millennium Development Goal
MIC	'Middle Income Country'
MTSEF	Medium Term Social and Economic Framework
NGO	Non Governmental Organisation
OA	Official Assistance
ODA	Official Development Assistance
ODF	Official Development Finance
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
PRSP	Poverty Reduction Strategy Paper
SWAp	Sector Wide Approach
TA	Technical Assistance
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UMIC	Upper Middle-Income Country
USAID	United States Agency for International Development
WB	World Bank

1 Introduction

The 'Millennium Aid Consensus' – which we characterise in Section 2 below – has involved a stronger focus on poverty, and hence on the poorest countries. A number of bilateral aid agencies have sought to increase the share of aid going to the poorest countries, with a corresponding decline in the share of funding available for 'Middle Income Countries' (MICs). New ways of working in the poorest countries are centred on Poverty Reduction Strategy Papers (PRSPs) with growing prominence for programme-based approaches such as Sector Wide Approaches (SWAps) and budget support, and greater emphasis on harmonisation amongst donors. This has left aid agencies wondering how they should treat aid recipients who are not among the poorest countries. What is the rationale for aid to so-called MICs? And do the emerging rules of good aid practice apply to MICs in the same way as they do to Low Income Countries (LICs)?

The British and Spanish aid agencies (DFID and AECI) have agreed a joint programme of work to explore the role of aid in MICs, and to discuss and share the issues raised with other European Union (EU) member states, partners in the Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) and the multilateral agencies. The present paper was originally commissioned by DFID and the AECI as a background discussion piece to identify the parameters of this theme, considering, *inter alia*, the applicability to MICs of the assistance framework developed for Low Income Countries.

As part of the same exercise, in late 2003 AECI and DFID conducted joint exploratory visits to Bolivia, Colombia, Peru and Jamaica to see how aid operates in a sample of Western Hemisphere MICs. The visits were limited in scale, but through discussions with governments, official aid agencies, NGOs and civil society organisations, they investigated some of the issues raised in an earlier, unpublished version of this paper (Eyben, Lister and Olivié 2003). The informal reports from the country visits have helped to sharpen and illustrate some of our original points, but also highlighted some additional features which are reflected in this revised and reorganised draft. In particular, they reinforced our attention to the institutional framework for aid relationships.

However, the paper remains a think-piece – designed as much to stimulate further thought as to propose particular conclusions. Our country examples are biased towards Latin America and the Caribbean, but MICs are heterogeneous and one of the follow-up tasks should be to explore whether the same issues are salient in the 'Middle Income Countries' of other regions.

The paper is organised as follows:

- Section 2 characterises the Millennium Aid Consensus and its implications for aid practice. Noting that the consensus focuses especially on poorer countries, we consider prima facie ways in which MICs might require different approaches/behaviour, and this provides the agenda of issues explored in the rest of the paper.

- Section 3 considers the definition of MICs. We note anomalies and confusions that can arise from different approaches to classification; we also explore conceptual and practical issues surrounding "graduation" from one level to another.
- Section 4 reviews the reasons (in principle and in practice) why aid agencies are involved with MICs. We note that actual motives are complex, and that aid agencies' behaviour is strongly influenced by their different histories, mandates, interests and ways of working. We also discuss issues of inequality and power relations as they relate to MICs.
- Section 5 discusses good practice for aid to MICs. We highlight ways in which the aid environment may differ from LICs and explore the implications for aid agency choices.
- Section 6 offers our general conclusions and proposes issues for further study.

2 The Millennium Aid Consensus

2.1 What is the consensus?

Key elements of the Millennium Aid Consensus are:

- *Focus on the Millennium Development Goals (MDGs).* This in turn implies recognition (a) that poverty matters, (b) that poverty has many dimensions, and (c) that growth *per se* is not an adequate answer to poverty.
- *Belief that aid can be effective if the institutional and policy context is right.* Hence: (a) a focus on policy reform, institutional development and capacity building, and (b) arguments for concentrating resources on good performers. (At the same time, the problem of countries that are both poor and poor performers is addressed under headings such as LICUS.[1])
- *A set of aid management principles* to which the Comprehensive Development Framework (CDF) label is often attached.[2] These stress the importance of donors building on (a) the country's development vision and agenda, (b) a systematic and comprehensive diagnosis, and (c) an informed view of what others – including the private sector – are doing.[3]
- *Attention to aid effectiveness.* In particular, recognition that traditional modes of aid delivery – uncoordinated projects managed outside of government systems – have been unsustainable, have imposed unnecessary costs on government, and have undermined the development of government capacity, at least in aid dependent countries. Hence there are pressures for harmonisation among

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1 Low Income Countries Under Stress.

2 When the CDF was launched there was much emphasis on drawing up a CDF matrix as a tool for managing and monitoring different stakeholders' roles in supporting different aspects of development. The emphasis now is on the underlying principles that inspired the matrix. The PRSP is itself seen as an embodiment of CDF principles. Thus, while it is straightforward to identify countries that do and don't have PRSPs, it no longer makes sense to ask whether countries do or do not have a CDF.

3 This particular characterisation is taken from the World Bank's MIC task force report (World Bank 2001).

donors, stress on using and strengthening government systems, and advocacy for non-project approaches to aid, including Sector Wide Approaches (SWAps) and budget support.

- *Aid as part of a wider international system:* acknowledgement that aid should be part of wider efforts to establish a more favourable global economic and policy environment for poverty reduction.

The organisational expression of the consensus, and increasingly the paradigm for government-donor relations, is the Poverty Reduction Strategy Paper (PRSP) process. In principle, this stresses in-country development of pro-poor strategies in ways that increase the influence of local actors outside government. It facilitates coordination of donors around a nationally-owned and coherent set of macro and sector policies. It requires the articulation of structures for dialogue between government and the donor community, makes transparent the targets and indicators on which they agree to focus, and brings policy, institutional and capacity-building issues to the fore.

The PRSP paradigm has direct implications for the way in which donors should manage their individual aid programmes and for their relations with each other and with recipient countries. In particular it calls for a high degree of coordination among donors (working jointly with government) in each phase of aid management, from situation analysis (poverty, institutional framework, policy requirements) to aid delivery (at least: coordinated projects within common sector and macro strategies; at best: orchestrated budget support), to monitoring (of institutional quality, fiduciary standards, inputs, outputs, outcomes and poverty impacts).

2.2 Is it relevant to MICs?

It is not our purpose to review the validity of the whole Millennium Aid Consensus. However, it does appear to represent a significant re-write of the "rules of the game" (Craig and Porter 2003) and as such it raises some urgent questions for aid agencies. Notably:

- Given the emphasis on poverty reduction, what are the justifications for aid to MICs?
- Are the preferred aid instruments and aid management frameworks for Low Income Countries relevant for MICs? For example:
  - Is the PRSP approach appropriate? If the whole package is not appropriate or feasible, should parts of the approach nevertheless be used? For example, is it still important to have a common strategic focus? Should agencies share analytical work? Does joint analysis constrain possibilities for recipient governments to be offered the choice of different approaches to complex problems?
  - Are problems of burdens imposed by donor practices more or less serious in MICs? Does poorly designed aid have de-capacitating effects even when aid volumes are low?
  - If messages about country ownership and coherence among donors are relevant in MICs, what (in the absence of formal PRSP disciplines) are the incentives for donors to act coherently? Are MIC governments interested or concerned about donor

coherence or the lack of it? Is ownership less or more of an issue in countries where governments do not perceive themselves as aid dependent?

  - How should the aid management framework take account of the greater relative importance of non-concessional flows (including those provided by agencies – notably International Financial Institutions (IFIs) – that can provide both)?
  - What are the implications for balance between different types of agency (bilateral/multilateral etc)? What are the comparative advantages of multilateral development banks (MDBs), other multilaterals and bilaterals, and what does this imply about the optimal channelling of aid?
  - Are global programmes of greater relative importance, and if so what are the implications for aid effectiveness and coherence?

- How serious are problems of diversity in donor aims? (In particular, for how many MIC donors is poverty reduction really the primary consideration?) Is aid to MICs more vulnerable to being shaped by non-MDG concerns of both donor and recipient governments?
- To what extent is aid to MICs primarily about addressing real fiscal constraints as distinct from deploying human and financial resources to support innovation and piloting by discrete sections within government and civil society?
- How serious are divergences between government and donor concerns about poverty? Are issues about working with civil society, on advocacy etc, more important in MICs, and/or do they require different approaches? How important are (international and local) non-government channels for aid? Do donors engage effectively with the (presumably) richer array of Civil Society Organisations (CSOs), academics etc in MICs?

These are big issues for a small paper! As we discuss in the next section, MICs are heterogeneous and the LIC/MIC classification is a continuum, so we have to be wary of over-generalisation. On the other hand, as we consider in our conclusion, while these questions have no easy answer there are emerging examples of good practice that can inform the debate and clarify negotiations over aid policies and programmes.

3 Defining MICs (choosing a view of the world)

MICs are defined differently by different agencies and in different contexts. (Annex A compares Development Assistance Committee (DAC), World Bank and United Nations Development Programme (UNDP) classifications in detail.) Definitions matter for both practical and conceptual reasons. Practically: (a) different definitions yield very different country groupings, and generalisations about MICs are hostage to the particular definition used; and (b) arbitrary thresholds between one category and another can have significant effects for the countries that are borderline. Conceptually, different classification criteria have different policy implications, while the idea of graduating countries from one level to another may reflect questionable theories of development. In this section we take the DAC's definition of aid and its classification of aid recipients as a starting point. We then contrast this with the alternative classifications used by the World Bank and in the UNDP Human Development Reports. We critically examine the concept of "graduation", and, finally, we illustrate some of the practical consequences for countries which find themselves on the border between LIC and MIC classification.

3.1 The OECD DAC classification

3.1.1 What counts as aid [4]

OECD DAC defines aid on the basis of (a) the developmental purpose of the flow; (b) a grant equivalence of 25 per cent or more; (c) developing country status of the recipient. The DAC list of aid recipients is divided into two parts: the "traditional" developing countries in Part I and "more advanced" Eastern European and developing countries in Part II. Only aid to Part I countries counts as Official Development Assistance (ODA); aid to Part II countries is classified as Official Aid (OA). Official Development Finance includes ODA, plus non-concessional lending by MDBs, plus other official development flows that have too low a grant equivalent to qualify as ODA.

These wider categories (OA and ODF) are important for MICs because many MICs are on the Part II list, and non-concessional lending by MDBs is often an important component of development financing in MICs (as well as being the dominant business of several regional MDBs – see Box 3.1).

Box 3.1 Concessional and non-concessional development finance from IFIs

Gross disbursements 2002 a	**Concessional**	**Non-concessional**	**Total**	**Concessional**	**Non-concessional**
	$ million, at current prices and exchange rates			*percentages*	
World Bank (IDA/IBRD/IFC)	6,923	9,789	16,712	41%	59%
IMF b	2,936		2,936	100%	0%
AsDB/AsDF	1,168	3,067	4,235	28%	72%
AfDB/AfDF	741	679	1,420	52%	48%
IDB	425	5,508	5,933	7%	93%
Caribbean Dev. Bank	113	108	221	51%	49%
EBRD	44	627	671	7%	93%
Total IFIs	**12,350**	**19,778**	**32,128**	**38%**	**62%**

(a) To countries and territories on Part I of the DAC List of Aid Recipients.
(b) IMF Trust Fund and PRGF.
Source: OECD DAC (2003: Table 17).

4 See Annex A for the full DAC definitions of ODA, OA and ODF.

3.1.2 The DAC classification

Box 3.2 shows the DAC classification of aid recipients, incorporating its definition of MICs as those whose per capita incomes range between $746 and $9,205.[5] MICs are subdivided into Lower and Upper MIC brackets.

Box 3.2 DAC classification of aid recipients

Category	***Income range (per capita GNI in 2001)***
Part I: Developing countries and territories (Official Development Assistance)	
1. Least Developed Countries (LDCs)	Poverty is a major criterion but not the only one for LDC status
2.Other Low Income Countries (LICs)	<$745
3. Lower 'Middle Income Countries' (LMICs)	$746–$2,975
4. Upper 'Middle Income Countries' (UMICs)	$2,976–$9,205
5. High Income Countries (HICs)	>$9,206
Part II: Countries and territories in transition (Official Aid)	
6. Central and Eastern European countries and New Independent States of the former Soviet Union	In practice, some of the transition countries appear in Part I of the DAC classification. Most, but not all, of the Part II countries are in the middle income ranges.
7. More Advanced Developing Countries and Territories	

The classification of countries into high, middle and low income groups is bound to be somewhat arbitrary. Leaving aside the problems of income concepts and their measurement in ways that are internationally comparable, it is worth noting:

- Various deliberate anomalies, including:
  - Some countries qualify as LDCs on non-income grounds: at least half a dozen of the LDCs listed – mostly small island states – are MICs on the pure income criterion.
  - An important group of European and former Soviet Union MICs are classified separately by the DAC as recipients of Official Aid rather than Official Development Assistance (ODA). Of these Ukraine is on the border between low and middle income categories. (But a number of the central European and former Soviet states do appear in the ODA category – see Annex A.)
- The large range within brackets: the per capita income at the top of the LMIC range is four times the MIC threshold, and the top of the UMIC range is over 12 times the threshold.

[5] These particular income thresholds, with adjustments for inflation, have persisted since they were first introduced into the World Bank's operational guidelines as a basis for determining eligibility for IDA and IBRD lending. However, as noted below, other factors than income are involved in determining this eligibility.

- Volatility: country movements from one category to another (in either direction) can make a big difference to aggregate data. Annex A shows that three countries – Georgia, Papua New Guinea and Uzbekistan – were relegated from MIC to LIC status between 2001 and 2003. Two were promoted – Honduras, population 6.6m, and China, population 1.3bn. Also, as Box 3.3 illustrates, several countries have oscillated between LIC and MIC status, while a larger number have slipped from MIC to LIC without returning.

Box 3.3 Income status transitions since 1980

Over the last 20 years 38 countries have fallen back from MIC to LIC status, with only 10 managing to return to MIC status in subsequent years:

Movement	No of countries	Examples
MIC to LIC without return	21	Angola, Azerbaijan, Ghana, Kenya, Yemen, Nicaragua, Tajikistan, Nigeria, Moldova . . .
MIC to LIC to MIC	9	China, Egypt, Guyana, Maldives, Turkmenistan, Armenia . . .
MIC to LIC to MIC to LIC	6	Georgia, Indonesia, Lesotho, Togo, Senegal . . .
MIC to LIC to MIC to LIC to MIC	1	Albania
MIC to LIC to MIC to LIC to MIC to LIC	1	Sudan

Source: From [DFID: *Annex A Strategy for Achieving the MDGs: The 'Middle Income Countries'*] based on World Bank data.

3.1.3 Aid dependence

Aid dependence is conventionally defined in terms of the ratio of aid to GDP (a measure of country dependence), or of aid to public expenditure (a measure of the government's dependence). The significance of aid relative to other resources clearly has implications for aid providers' ability to influence policies and resource allocations of the recipient, as well as for the possible collateral burdens of aid to the recipient (possible burdens include the direct transaction costs of managing aid as well as adverse effects on the integrity of public expenditure management and government capacity). Less tangibly, but no less important, aid dependence may be a state of mind or pattern of behaviour: some countries that receive a lot of aid are nevertheless jealous of their sovereignty. Much discussion about aid and MICs conflates two attributes that are only somewhat correlated – higher income levels and lower aid dependence. For many MICs, non-concessional development finance may be more significant than ODA.

3.2 Alternative criteria and anomalies

3.2.1 The World Bank classification

The World Bank Task Force on 'Middle Income Countries' defines as MICs all those countries which are eligible for (or restricted to) International Bank for Reconstruction and Development (IBRD) and

IBRD/IDA (International Development Association) blend financing.[6] Although the DAC and World Bank use the same income thresholds, IDA eligibility is determined by a mix of economic and political factors. A number of LICs are excluded, on the grounds that they have access to international capital markets. (Consistent with this perspective, the WB MIC task force considered classifying MICs – defined in terms of IBRD/IDA eligibility – into low, medium and high capital access countries.[7])

This approach – which makes good sense from the World Bank's management standpoint – includes Azerbaijan, India, Indonesia, Nigeria, Pakistan, Papua New Guinea, Uzbekistan and Zimbabwe – all Low Income Countries – into the WB definition of MICs, while 'Middle Income Countries' that are still eligible for IDA funding – Albania, Guyana, Honduras, Sri Lanka and Tonga – are excluded. (Table A1 in Annex A shows the all the discrepancies between World Bank and DAC classifications.)

Different classifications and promotions/relegations make huge differences to the generalisations that can be made about MICs (hardly surprising, since the "swing" countries include India, Indonesia, Nigeria, Pakistan and China).

Further big differences to the headline data about MICs can come from taking the US$2 per day instead of the US$1 per day definition of poverty. White argues for the latter. Although the $2 a day line allows the line to increase with income, thus providing for a relative view of poverty that accords with nationally generated perceptions of the problem, he suggests that nevertheless it would not be appropriate for aid management purposes because it would be setting a moving target (2000: 5). On the other hand, as discussed later in this paper, if we consider the purpose of aid to be not necessarily or solely to meet fiscal gaps but also to support internal processes of change, then other, nationally generated measurements of poverty may well be appropriate.

3.2.2 The Human Development Index

UNDP's Human Development Reports rank countries (high, medium and low human development) according to a composite Human Development Index. Annex A (Table A2) compares Gross National Income (GNI) and HDI rankings; there are many cases where a country's HDI grade is higher than its income grade. A working assumption might be that such countries have higher technical capacity than their income peers.

3.3 Development as graduation

There are also more fundamental issues here, not only as to whether per capita income is the best way to encapsulate "levels of development" but also whether it is appropriate to visualise development as a process of graduation from lower to higher steps on a development escalator. The World Bank and DAC

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6 Other MDBs also classify their borrowers in similar fashion. For example, Inter-American Development Bank (IADB) classifies Jamaica as 'C' in a scale running from 'A' (the richest IADB borrowers) to 'D' (the poorest). This classification, combined with the poverty-focus of a loan, determines the proportion of counterpart funds IADB expects from borrowers.

7 See Table 5 in *Middle Income Countries: Development Challenges and Growing Global Role*, Peter Fallon, Vivian Hon, Zia Qureshi and Dilip Ratha, World Bank, August 2001.

do this on the basis of national income; the UNDP on the basis of the level of the composite human development index. The assumption underlying both systems is that of linear progress from a lower to a higher stage of development. Some countries, for example in East Asia, do appear to have followed that trajectory, but many have not (as illustrated in Box 3.3 above).

This way of understanding the world envisions a final stage of maturity, exemplified by the older members of the OECD and places 'Middle Income Countries' in some uneasy adolescence. As they grow up dependency on adults will diminish and a relationship on more equal terms will be established. For example, Swedish development policy states that cooperation should gradually evolve into more equal political, trade and cultural relations (Government of Sweden 2003). The World Bank notes that the experience gained in 'Middle Income Countries' can inform the advisory and knowledge base for the Bank work in low income countries.

This concept of development is so ingrained that it has become "natural". In other words, we find it difficult to imagine that we can look at the world any other way. The quandary concerning the role of aid in 'Middle Income Countries' derives from this "natural" perspective. An alternative view would be to think of development as a complex process that cannot be predicted based on the history of one particular group of countries (the founding members of the OECD). We should avoid the implicit historicism which assumes that a particular sequence of events at a specific moment in time is replicable in other places and times (Williams 1983: 146–8; Rist 2002: 74–5).

Changes at the national and international level may occur in sudden and unexpected ways and may not necessarily lead to improvements in people's well-being. Improvement is neither inevitable nor systematic and there are no universally applicable recipes for its sustained achievement. This alternative view allows us to reconsider the role of aid from rich countries to poorer countries, recognising that the size of their GNP, or even their human development ranking, is only one element that should influence decisions as to how best to support efforts by people in these countries to move out of poverty. It could encourage a donor government to take a more explicit relational approach with other countries in the world and ask how, in collaboration with others, it should best support poverty reduction efforts

3.4 Practical consequences of classification

Classification systems also have non-trivial practical consequences. Marginal changes in a country's circumstances can lead to non-marginal changes in its aid environment. For example, Bolivia hovers on the LIC/MIC borderline; it is in danger of losing access to IDA, but unable to service non-concessional borrowing. This creates uncertainty for the Bolivian government, and transaction costs for World Bank staff in making special pleadings to preserve IDA access. If MDBs withdraw because they can no longer provide ODA and there is no effective demand for non-concessional finance, they may cease to provide analytical work on which bilaterals habitually draw (the World Bank's disengagement from Jamaica was cited by bilateral donors there).[8] A major concern in the WB MIC task force report was that countries may still want their technical advice, but not the borrowing that usually finances it.

Crossing the threshold from LIC to MIC creates a decision point that can throw light on the different motivations and interests of different stakeholders. DFID has blended some of its aid to China with World Bank loans, to soften their terms back to IDA equivalence. The Chinese government prefers not to borrow for the social sectors, but DFID's concerns for poverty reduction have led it to change the financial incentives the government faces. (One of DFID's arguments is that graduation applies to a whole country that still contains many poor regions.) This is agreeable to the World Bank, since it enhances the breadth as well as the volume of its China portfolio.

Overall LIC/MIC spending targets may also be arbitrary and will have unpredictable consequences if applied rigidly. (E.g. if populous countries graduate, the share of spend for poor people in MICs will be arbitrarily reduced unless the headline target is adjusted.)

3.5 Possible sub-groupings

Unless otherwise specified, our references to MICs are based on the DAC classification. At the same time, one should be aware that much of the discussion about aid and MICs conflates two attributes that are only somewhat correlated – higher income levels and lower aid dependence. We hope context will make it clear which defining characteristic is uppermost in our thoughts in what follows.

It is clear that the countries involved are very diverse – in population, geography, culture, history, HDI scores and indeed income. When and for what purposes does it make sense to consider MICs as a group? It largely depends on why the classification is wanted:

(a) Is the classification for analysis, for determining aid eligibility, or as a basis for organisation and action with the groups concerned?

(b) Is the commonality that countries are less poor? In that case, it may be important to remember that MICs cover a wide income range (see Box 3.2) above, and that there are many poor people in MICs (see Section 4 below).

(c) Is the commonality that countries are less dependent on aid – they need it less or are offered less? For the MDBs this is a particularly important way of classifying their clients, since it determines the terms of their access to credit[9] and the size of the market for MDB services. For all donors, and for donors collectively, the level of aid dependence affects the forms of dialogue and influence that are available.

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8 Bilateral-multilateral dynamics are further discussed in Section 5 below.

9 Hence, the WB MIC task force considered classifying MICs (defined in terms of IBRD/IDA eligibility) into low, medium and high capital access countries. See Table 5 in *Middle Income Countries: Development Challenges and Growing Global Role*, Peter Fallon, Vivian Hon, Zia Qureshi and Dilip Ratha, World Bank, August 2001.

(d) Is the desire to have groups that are in some senses homogeneous, or sharing common problems or common relationships? If so, the MIC classification may actually cut across geographical groupings that correlate, though not perfectly, with the distinct but overlapping catchments of the major regional banks (AsDB, AfDB, IADB, EBRD) the UN regional agencies, (UNECA, ECLAC, ESCAP, etc), and other regional institutions.

This last issue relates to who determines the groups. Are groupings according to donor perspectives consistent with how such countries categorise themselves according to other criteria that cut across the donor classification system(s)? Examples would be common membership of a geographical region such as the Mekong Basin, or the Andes, cultural affinity such as the Turkic speaking countries of Asia, or membership of a free trade zone. How and to what extent does the donor MIC-LIC view of the world influence policy and practice in relation to these other classification systems?

Our general impression is that, both for analysis and especially for organisational purposes, it will usually make most sense to consider "MIC issues" within the context of regional, geographical and cultural groupings of countries, whose membership is rarely exclusively MIC. Comparing countries that have strong common elements is useful, not because of any assumption of linear progress, nor because they are assumed to require the same formulas, but because their similarities may make their differences more revealing. Taking a regional grouping perspective also throws light on the relations between countries in the region. For example, some MICs are sources of financial and technical aid for neighbouring LICs and may play a leadership role in international fora and trade negotiations as well as in regional conflict resolution. An aid relationship with a significant regional MIC might well in an indirect way bring significant benefits to a neighbouring LIC. As we discuss in the next section, this is one of the reasons why aid agencies might be interested in MICs.

4 Why aid agencies are/should be interested in MICs

4.1 Introduction

Why and how donors give aid (in MICs and elsewhere) is linked to assumptions about the objectives of aid and the nature of relationships (between giving and receiving governments, and between receiving governments and their citizens). This section raises a number of issues that are likely to be more important or at least more obvious in MICs than in LICs. The reasons for wanting and receiving aid are likely to be more complex in MICs than LICs because of a wider range of interests at play in both receiving and giving countries.

General statements about why MICs are important from an aid perspective are imperilled by the definition and the poverty line chosen (in particular the WB studies which are often quoted link the WB-specific definition, which includes several populous LICs, to the $2 a day poverty line). However, the basic reasons why OECD governments are interested in MICs are (a) poverty (and other MDGs),

(b) international public goods and (c) other aspects of bilateral and multilateral relationships, relating to commercial and political interests (White 2000).

It is important not to confuse the positive (why richer countries do provide assistance to poorer ones) with the normative (why they should do so). The role of aid has to be understood in the wider context of international relations. The "*realist*" approach to international relations assumes that each country pursues its own interest and that aid is a part of that pursuit. This could explain why countries with similar problems of poverty and governance may get different amounts of aid. The *normative* approach does not disregard the possibility of national self interest but also notes there may be a strong constituency in the aid-giving country that favours a more equitable and just world (Willets 2001).

It is quite common for aid agencies to seek to reconcile altruistic and self-interested motivations. Thus the new Swedish global development policy document stresses that its foundation is solidarity with poor and vulnerable people in other countries and recognition of its shared responsibility for the future of the world (Government of Sweden 2003). At the same time, the same policy document argues that there is no conflict between this solidarity objective and the promotion of Swedish business and research interests 'in order to maintain Sweden's position in an environment that is often dominated by considerably larger and more influential countries' (ibid: 79).

Donors who are required to focus strictly on poverty reduction[10] nevertheless need to take account of the wider interests that influence how other agencies operate. Different countries and different aid agencies have different perspectives that are shaped by their histories, constituencies, mandates, governance structures and habitual ways of doing business. Agencies with ostensibly similar objectives may still have strikingly different ways of managing aid. Agencies with clear objectives but more flexible operating guidelines have an opportunity to add more value by making their programmes complementary to those of less flexible donors (a point that is further explored in Section 5).

4.2 Supporting the reduction of inequality and social exclusion

There is substantial poverty (along with other MDG deficits) in MICs. Arguably, in such countries there is sufficient wealth for all individuals and their children to escape from absolute poverty. Thus, inequality is understood as cause, explanation and outcome of the continued existence of poverty. Severe or growing inequality is also seen to contribute to political unrest and social instability that in turn affect people's livelihoods and their capacity to contribute to sustained economic growth.

Debating about the significance of inequality in MICs, and why the countries need external aid to tackle it is not helped by the fuzzy way in which policy-makers and others often define the concept. Ambiguity in understanding is sometimes politically useful but it can also lead to ineffective aid with human and financial resources deployed to tackle symptoms rather than causes.

In aid circles, "inequality" is commonly understood as observed (measured) inequality in distribution and/or consumption. This is the principal approach of the World Bank and other international finance

[10] Such as is required by the UK International Development Act 2002.

institutions. They understand inequality in terms of disparities and quintiles and use the Gini coefficient to measure the extent of unequal distribution in income.[11] Economists use modelling to find out how changes in the distribution of income among a population can have adverse or positive effects in terms of the proportion of the population living in poverty (as defined by an income or consumption figure). Inequality, understood in this distributional sense can also considered in relation to assets such as land or human capital such as educational attainments.

Box 4.1 Unpacking the meanings given to inequality in development practice

Observed (measured) *inequality in distribution and/or consumption*. This is the principal approach of the World Bank. It looks at inequality in terms of disparities and quintiles. Income differential can be compared against other ways of classifying humanity, for example on the basis of sex, age, geographical location.

Inequality as difference in opportunity. This approach is based on concepts of status and rank in social systems. Class and other status ascriptions such as gender, age or ethnicity are understood as determining opportunities, for example in access to education or health care. "Social inequality" is commonly used in this sense of the term.

Capability deprivation is the approach that underlies the human development index developed by the UNDP Human Development Reports, building on the work of Amartya Sen and concerned with the extent to which people have the freedom to make choices in their lives.

Rights based approaches premised on the universality of human rights in which everyone has equal rights. The DFID policy paper (2000) notes that in practice it is often particular groups of people who cannot claim their rights in different areas of their lives because of discriminatory policies that result in inequitable outcomes. This leads to an interest in political inequality, citizenship and good governance. Much current work on rights has evolved from participatory approaches to development.

Social exclusion: 'the process through which individuals or groups are wholly or partially excluded from full participation in the society within which they live' (De Haan 1999). The value of the concept is the potential to explore the processes that cause exclusion and thereby deprivation.

Vertical and horizontal inequality distinguishes between differences in income, on the one hand, and differences between categories of the population in terms of ethnicity or gender, on the other hand.

(Based on Eyben and Lovett 2004.)

There is a wide variation in the Gini coefficient across MICs varying from 21.7 in Belarus to 74.3 in Namibia and it has been suggested that the conventional wisdom that inequality is higher in MICs than LICs is not well founded as there are high levels of income inequality there as well, particularly in Africa (McKay 2004). However, the Gini coefficient simply takes a snapshot of a particular moment in time and tells us nothing about the kinds of people who are rich and the kinds who are poor and the pattern of relations between them that make it harder or easier for people to move out of poverty. Thus, for example, it may be that despite the high Gini coefficient in parts of Africa, social and political networks and shared identities that include both rich and poor result in very different perceptions by policy-makers concerning what is happening in their society, as compared with some MICs where the Gini coeficient may be an indicator of historically deep divisions between different sections of society. Policy responses to inequality are shaped less by the height of the Gini coefficient than by the extent to which citizens perceive such income inequality to be fair (Humphrey 2001).

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[11] The Gini coefficient is a number between 0 and 1, where 0 means perfect equality (everyone has the same income) and 1 means perfect inequality (one person has all the income, everyone else earns nothing).

Inequality can be understood as relational as well as categorical – the second is an imperfect way of measuring the first and complementary qualitative methods are required to fully understand the processes that create and reproduce inequality. The processes leading to unequal distributional outcomes are often described as those of "social exclusion". Because such processes cannot be easily quantified and measured they are difficult for bureaucratic systems to get to grips with. Aid agencies should be cautious of encouraging measurement when it might lead to a solidification of difference that can fuel conflict over allocation of resources or access to power.[12]

If exclusion is understood as the processes that lead to different distributional outcomes, donors could enquire as to how global and national economic and social policies could contribute to influencing the transformation of these processes so that measurable indicators would be less skewed. *The important point here is that policy-makers should not see themselves as directly trying to change the indicators but rather playing a role in shaping the processes.* This might require quite different kinds of action in different places because while the measurable indicators may look similar in two different countries, the specific processes that led to them are likely to be historically contingent and possibly different.

Thus, the challenge for aid agencies is to determine how best they can support processes that have the potential to reduce rather than reinforce exclusion. The complex and contingent nature of social change and the impossibility of predicting that a particular event will lead to a certain outcome suggests a possible approach to donor action is to develop long term and consistent *relations* with selected recipient organisations who are pursuing a social change agenda that is compatible with the donor's own values and mission. Rather than aiming to achieve a predetermined specific real world change in which the recipient organisation is treated as an *instrument* to that change, the focus of donor effort would be in supporting that organisation's own efforts in what may be a rapidly changing policy environment.[13] Quite small interventions may have disproportionate effects in the long run. DFID's work on partnerships in Brazil is an example of how a very small financial investment in strengthening the relationships between state government, civil society and an IFI, brought about significant shifts in social policy (Larbi-Jones forthcoming).

The international human rights framework can provide some overall guidance in making choices for donor choices in terms of the organisations they select to establish relationships with. The DFID policy paper (2000) notes that in practice it is often particular groups of people who cannot claim their rights in different areas of their lives because of discriminatory policies that result in inequitable outcomes. This leads to an interest in political inequality, citizenship and good governance. A fresh but challenging approach from this perspective is to consider inequality as the condition, process and experience of the

12 See, for example, Appadurai's (1993) discussion on measurement and the caste system.
13 For a full discussion on this point see Groves and Hinton (2004).

power relations that constrain individuals, communities and even wider groups, such as nation states, from the same freedoms that are enjoyed by those with whom they are in a position of subordinate relationship.

This political perspective would challenge statements such as that made in the Joint Issues Paper submitted to the Seminar on Development Cooperation and 'Middle Income Countries' held in Madrid in November 2002 where it was noted that a major problem in addressing poverty is a lack of information about the poor. *An alternative argument to the Joint Issues Paper is that it is not information that is absent in MICs but rather a lack of interest of those in power to change the status quo.*

Aid has conventionally been a technical matter that constructs knowledge to support policy through instruments such as statistical surveys. However, should aid agencies continue to view poverty as a technical matter without paying attention to the power relations that sustain the high levels of poverty in Latin America and some other 'Middle Income Countries'? By ignoring power, aid risks helping to maintain rather than transform the processes that keep people poor. The conflict and social unrest that can arise from the persistence of exclusive processes can of course also prevent growth and commercial opportunities to foreign investors. During the AECI/DFID visit to Peru, civil society representatives commented that inequality was the most pressing development issue but opinions were mixed as to whether this was a legitimate area for foreigners to be involved in because of its politicised nature. While such political questions raise difficult issues for donors, they are worth asking when considering channels for aid, discussed in Section 6.

4.3 International public goods arguments

What happens in MICs has an important influence on the rest of the world, including the Low Income Countries. A World Bank study puts the international public goods case for engagement with MICs as follows:

> The MICs are of systemic importance in key areas with the characteristics of global public goods, including poverty reduction, financial stability, protection of regional and global environmental commons, public health, orderly flows of trade, movement of capital and labour across borders, and control of trans-border crime including money laundering and drug trafficking. Reform-minded MICs are producers of global public goods; reform-averse MICs may thus be said to be potential producers of global public bads.
>
> (Fallon *et al.* 2001: 3)

Thus there are both altruistic and non-altruistic reasons for wanting to reduce poverty in MICs: it may be valued for itself, and also seen as a contribution to global peace and stability and the expansion of global markets (including for LICs). The other public goods are similarly ambiguous. MICs have global environmental importance through forests, biodiversity and greenhouse gas emissions. International health threats such as HIV/AIDS necessarily involve MICs, as do other trans-border issues such as crime and drug trafficking. MICs are also more vulnerable to financial systemic risk than either developed countries or LICs and have been involved in contagious financial crises in Asia and Latin America (see Box 4.2).

Box 4.2 MICs' interest in the international financial architecture

After the eruption of the late nineties crises, academics and international financial institutions renewed the debate on the causes of financial crises. Two main approaches could then be identified. On the one side, the conventional approach considered that mistakes in economic policy – mainly financial and banking mismanagement – led to the eruption of financial crises in South East Asia and Latin America. On the other side, a more heterodox focus stated that financial globalisation has had a leading role in the triggering of these crises. Academics have now come to a certain consensus that recognises the role of globalisation in financial crises.

The process of financial globalisation has provoked a great increase of international financial flows. Most of these flows are from developed to developed countries and a smaller proportion is invested in developing countries. The main developing recipients of these flows are a small group of countries –the so-called "emerging markets"– which are, most of them, 'Middle Income Countries' (China, Argentina, Brazil, Mexico, Thailand, Malaysia, Indonesia, the Philippines, Russia etc.). Besides, a high proportion of capital flows to these countries has a short-term maturity (short-term debt contracts, financial derivatives) and/or are liquid (portfolio investment –equities and debt securities).

Liquid and unstable capital is more easily invested (and disinvested) in any country all over the world. Therefore, investors can over-react to any political, economic and social change creating a massive volume of capital inflows and outflows. Hence the volume and nature of international capital is creating increasing financial instability worldwide. This instability is having wider and severe economic and social effects:

- Emerging markets have weaker financial structures than developed countries and, in many cases, massive capital inflows distort these structures. Moreover, capital outflows can provoke financial crises with severe economic and social consequences –mainly a rise in people living in poverty.
- Financial, productive and trade linkages between emerging markets and other developing countries open the door to the contagion of emerging market crises to other middle income or low income countries ("Tequila effect", for instance). The enchained crises of the late nineties resulted in a decrease of capital investment in developing countries.

Possible solutions to these problems can be found in the so-called international financial architecture (IFA) which could be defined as the overall structure (agents and operative mechanisms) of international financial markets. Several issues have arisen in the debate on how to build a safer and more stable globalisation process: the creation of a new financial institution with the capacity to control the nature and destination of financial flows; international and national capital controls in order to contain the inflow and outflow of unstable capital; strengthening financial supervision and regulation at a recipient country level; the implementation of more stable exchange rate regimes in developing countries and regulation and supervision of financial derivatives.

Public goods issues were prominent in the MICs visited for this study. Aside from their interest in international trade, finance and environmental issues, assuaging internal conflict that has external repercussions is a major concern for donors in Colombia; the drugs trade and the USA-supported coca eradication programmes are a central concern in both Colombia and Peru, while three of the countries most affected by Jamaican crime are providing aid to that country's police force. (See Section 5 for more on the aid environment in these countries.)

It is worth noting that many of these public goods concerns give rise to vertical, "single issue" programmes, such as the Global Environment Facility, global funds to address AIDS and other major diseases, anti-drug campaigns, etc. Such vertical programmes are likely to be proportionately more important in less aid-dependent MICs. An important role for in-country donors and their review mechanisms may be to monitor how international vertical programmes interact with each other and with conventional programmes at country level. E.g. is a vertical HIV/AIDS intervention adequately integrated with other health services? How does aid focused on anti-drug campaigns affect poverty strategy? and so forth.

Equally, helping MICs to pursue their interests in international public goods more effectively (e.g. by strengthening their capacity for trade negotiations) may be more valuable to them than financial aid.

Another externality argument is the belief that by giving aid to these countries donors can learn good practice for aid to LICs. The MIC combination of less aid dependence, different country contexts and more varied motives for aid means that donors have to learn to be agile and adapt to different circumstances.

4.4 Whose power, whose voice, whose knowledge in the relationship?

In a speech two years ago on the role of aid in MICs a World Bank vice-president made an explicit comparison with the EU policy on structural funds for disadvantaged regions within the Union (Linn 2001). This comparison is worth pursuing as it highlights the differences in the relationship between donor and recipient in the two cases. Structural Funds are the European Union's main instruments for supporting social and economic restructuring across the Union. Particularly relevant are the "objective one" funds for less developed regions in the EU. The procedures for allocating and managing the money are very different from that applied by EU member states to countries or regions outside the Union.

The EU structural funds are genuinely owned by the receiving member government who is part of a collective driving seat which is the EU Council of Ministers (CEPII 1999). Compared with aid to 'Middle Income Countries' the funds are allocated on an entitlement, rather than a gift basis. That means funding cannot start and stop on the caprice of the donor. The lack of certainty and predictability concerning duration and amount of aid constrains the efficient use of the resources. Recipients cannot plan their use ahead of time nor, despite the best efforts of the PRSP process do they have a strong voice in determining how the aid from a particular donor should be spent.

5 Good practice for aid to MICs

In this section we consider how the context for aid in MICs is likely to differ from that in LICs, and what this implies for donors (especially bilaterals) considering which countries to support, which channels to use for their aid, and how to adapt the principles of good practice to MIC circumstances. Illustrations are drawn from the four Latin America and Caribbean (LAC) countries visited in connection with this paper.

5.1 Institutional framework for aid management in MICs

5.1.1 General considerations

Recent good practice recommendations in the DAC guidelines on harmonisation (OECD 2003) have acknowledged problems that can arise from lack of coordination among donors and the simultaneous imposition of many different donors' procedures and conditions. It is stressed that the primary responsibility for coordination should rest with the recipient government, and that the primary arena for coordination and harmonisation should be in-country. At the same time, the background studies for the DAC guidelines, together with more recent work on aid instruments in Asia (Hubbard 2004; Lister 2003) have highlighted the level of aid dependence and the degree of congestion among aid agencies as key determinants of the aid management approaches adopted by governments and donors. The incentive to develop more elaborate systems for managing and coordinating aid, and to adopt programme based approaches to aid, is much greater where the number of donors is large and aid represents an important share of public resources.

In many aid dependent LICs, the imbalance in financial resources is underscored by scarcity of human capital (especially in the government sector), which is graphically illustrated when small numbers of high level government staff are overwhelmed by the huge visiting teams from donors. MICs are likely to be much less aid dependent, and are also likely to have greater management and administrative capacity.[14] There is likely to be less interest in the Millennium Consensus's holistic mechanisms for strategy formulation, government-donor dialogue and aid coordination. Donors have much less leverage to insist on such mechanisms if the recipient is not convinced of their merits, and in any case the volume of aid and degree of congestion and overlap between donors is much less likely to justify the transaction costs – for both sides – of more elaborate mechanisms. The balance of influence between different aid institutions may also be different: non-concessional development finance – which does not feature in figures of ODA per capita – is much more important in MICs, and should increase the relative importance of the IFIs which provide it (see Box 3.1 above).

[14] However, the correlation between income and human resource capacities is far from perfect. As Table A2 in Annex A illustrates, there are many inconsistencies between income and HDI rankings. The exploitation of natural resources, such as oil, may relax financial constraints without a commensurate improvement in the quality of a country's human resources and institutions.

Accordingly, the PRSP – at least so far – is a Low Income Country, and predominantly African, phenomenon.[15] Although the complete PRSP package may be inappropriate for most MICs, the relevance of its different elements can also be considered separately. For example, it may make sense for donors to share institutional and fiduciary assessments or monitoring of poverty outcomes even where project aid continues to be the dominant modality for aid delivery. It is still relevant to enquire about the strategic coherence of aid to MICs, and to investigate whether aid has a positive or negative effect on the capacity of the partner country and its government.

As noted, a central finding of the DAC country studies on aid effectiveness was that the key arena for coordination and harmonisation was at country level (OECD 2003). There may be practical difficulties in applying this insight to some MICs where, for example many donors may not have country level representation or may be less strategic in their commitment, and where the host country may have less interest in orchestrating donors collectively rather than dealing with them individually.

There may also be subtle differences in the relationship between poverty-oriented donors and the host government. Problems in LICs are more easily perceived as a shortage of resources, which aid can address. In providing aid to a Low Income Country there is an *a priori* assumption (often erroneous) that the recipient government is doing its best to improve the welfare of its citizens but lacks the necessary wherewithal. In those 'Middle Income Countries' with widespread, high and sustained levels of poverty this assumption is harder to make. Donors fear that their aid may be used by the ruling elite as a safety net or palliative, providing the means to avoid tackling deep-rooted problems. They start to look for ways to deploy their aid so as to influence processes that will lead to structural change, in other words, processes that will convince the elite that they should take responsibility for the poverty in their country.

5.1.2 Country examples

These issues were explored in the four LAC countries shown in Box 5.1. Although all are classified as Lower MICs, and three of them are neighbours in the Andean region, there are sharp contrasts that warn against superficial generalisations about MICs. Bolivia is much the poorest country overall, with a much higher proportion of its population in absolute poverty. It is also the only one that is significantly dependent on aid (the ODA/GNI ratio in the other countries is less than 1 per cent; in Bolivia it is close to 10 per cent). HDI rankings for the other three countries are quite close, with Bolivia a long way behind. Indeed, as we show in more detail below, although Bolivia is just over the LMIC threshold, its aid environment has much more in common with LICs than with its neighbouring MICs.

There are also illuminating contrast in the motives for, and the management of, aid in the other three countries reviewed. In all the cases, a small number of donors, usually ones with obvious regional and political interests in the country concerned, provide most of its ODA. Only in Jamaica (where the EC has

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15 From the most recent list of PRSPs and Interim PRSPs available (see Annex A), the only countries involved which are not Low Income (DAC classification) are Albania, Macedonia, Serbia and Montenegro, Sri Lanka, Bolivia, Honduras and Guyana. Of these, the last three have the incentive of debt relief under the HIPC initiative.

a strong presence) do multilateral agencies provide a large share of ODA – although, as we shall see, non-concessional development financing by multilateral banks is significant in the less ODA-dependent countries.

Box 5.1 Four LAC country aid profiles

	Bolivia		**Colombia**		**Peru**		**Jamaica**	
Population (2002)	8.7m		43.7m		26.7m		2.6m	
GNI per capita (USD)	900		1,830		2,050		2,820	
HDI ranking	114		64		82		78	
NET ODA/GNI	9.1%		0.6%		0.9%		0.3%	
Top donors (gross ODA): (share of top ten total)	Germany	29%	USA	69%	USA	32%	EC	31%
	USA	15%	Spain	7%	Japan	29%	USA	18%
	IDA	13%	Germany	5%	Germany	12%	CaribDB	12%
	IDB	11%	Japan	4%	UK	8%	Canada	10%
	Netherlands	8%	Netherlands	4%	Spain	6%	Japan	10%
	Japan	7%	EC	4%	Netherlands	4%	UK	7%
	Spain	4%	France	3%	EC	3%	Netherlands	4%
	UK	4%	IDB	2%	Switzerland	2%	Arab countries	4%
	Austria	4%	Norway	2%	Canada	2%	Germany	3%
	Denmark	3%	Sweden	1%	France	1%	Arab agencies	1%
Bilateral share of gross ODA	76%		92%		93%		55%	

Source: OECD DAC; UNDP HDR (2003).

Aid management issues in *Bolivia*, and the response to them, resemble those in aid dependent countries in other regions. Indeed, Bolivia has been something of a pioneer: the prototype Comprehensive Development Framework emerged here in 1999 (although the 2002 CDF evaluation (World Bank 2003) found that coordination amongst donors was still weak). A national dialogue in 2000 was part of the process from which the present poverty strategy derives. Despite this, issues of broad-based ownership were a problem from the start (Eyben 2004b) and there have been since serious governmental crises around implementation of key elements of national strategy, with the revenue issues and the regime for natural gas exploitation proving particularly contentious. The PRS objective of building a national consensus around politically divisive issues such as land tenure, ethnicity and social exclusion is likely to prove extremely challenging. As in many PRSP countries, the lack of an effective link between the strategy and medium term budgeting and resource management is a serious weakness; there is evidence that the strategy is not financially sustainable, but the mechanisms for costing and prioritising are poorly developed. Congestion among donors is evident, as are the transaction costs of aid, and the potential for project-focused aid to undermine government capacity. Response included a number of sector SWAps and pooled funding arrangements amongst donors, as well as moves towards coordinated budget support (Nickson 2002). As, technically, a LMIC, Bolivia has reached the limit of access to IDA and to IDB concessional lending, but poor credit ratings prevent the government from accessing IBRD resources. These and related graduation issues cause uncertainty but both the IMF and the World Bank have been flexible and helpful in making the case for Bolivia to all intents and purposes to be treated like a LIC.

The aid environment in *Colombia* is dominated by the continuing internal conflict, which has been sustained for more than a generation, has led to millions of people being internally displaced, with large areas of the country not under the effective control of the government. There is a sharp contrast between the roles of the multilateral development banks, which attempt to pursue a development agenda and of bilateral donors, for whom the conflict itself is the primary concern. Twenty-four foreign governments have joined together in a common Dialogue with the Colombian government, and there is a consensus among bilaterals that the G24 provides an effective mechanism for engaging with Colombia. Leadership amongst the donors rotates, the Swiss currently lead with UNDP providing a secretariat to the group. The presence of five Latin American countries in the G24 was seen as particularly important in terms of legitimacy and credibility with the Colombian Government. Brazil will lead the Group later in 2004. United Nations agencies, including the Office of the Commissioner for Human Rights, play a significant role. Coordination reflects the political rather than the monetary importance of aid. The government coordinating body (ACCI) has produced a plan for international cooperation focused on "democratic security" and the government is interested in more systematic monitoring of the MDGs.

While bilaterals channel a high proportion of their grants through national and international NGOs (partly reflecting the ability of NGOs to operate in areas not under effective government control), the multilateral banks channel sector loans through the government. Many donors feel that closer liaison with the MDBs would be advantageous, linking their social expertise to the humanitarian efforts of the bilaterals, and that the most efficient way to do this would be to involve them more in the G24 framework. The donor cooperation picture is already complicated by the perception that Plan Colombia (a US/Colombia bilateral plan which to many has become synonymous with controversial anti-narcotics policies) sits uneasily outside the National Development Plan and the Government's International Cooperation Plan.

Peru is the one sample country which lacks a well-articulated framework for donor coordination, with neither the aid dependence of Bolivia nor the urgency of the ongoing conflict in Colombia. Bilateral aid is largely focused on technical assistance (though, again, coca eradication is a major concern for the USA in particular). Despite the trend to higher priced lending, multilateral agencies in Peru are sustaining long-term relationships but there is no framework for coordination with bilaterals. Potential for coordination by the government is weakened by the fact that loans and grants are overseen by separate agencies, and line ministries themselves have powerful coordination units. Much bilateral aid is channelled via NGOs which do not come under the purview of the grant coordinating agency. With modest volumes of aid, the priority for harmonisation is a framework for strategic dialogue, not donor procedures (although there are, however, CDF best practice issues which would improve trust, particularly transparency in donor procedures and analysis). Government, donor and civil society representatives all noted that the lack of such a framework prevents a discussion about the most appropriate role for donors (which could centre on the provision of knowledge, not cash). This is particularly important for Peru as the long-term challenge of addressing inequalities is essentially political and the role of foreigners is contested. An outsider visiting is unlikely to see Peru primarily through a per capita income lens. Alternative starting points to consider include: an inequitable society; a post conflict state, a vulnerable transition economy, an emerging democracy; a stakeholder in an Andean political economy. These different starting points could lead to alternative debates about the role of outsiders. EU member state representatives see the long-term nature of the problems facing Peru: high inequalities, a fragile political framework, and social exclusion and the potential for conflicts. They agreed the danger then was a myopic debate about aid allocations to Peru rather than a strategic debate about what influence the donor community might have in the medium term to assist with some deeply embedded problems (i.e. the donor role not donor resources).

In *Jamaica*, the Government has an explicit poverty strategy. A review in 2003 of the Government's National Poverty Eradication Programme and an analysis of Jamaica's performance against the MDGs indicate that Government is continuing to give a high priority to poverty reduction. But a prevailing narrow view of poverty, weak implementation, over-emphasis on poverty alleviation (at the expense of prevention and reduction), all detract from the effectiveness of the efforts and resources that are applied. Jamaica is constrained by a heavy debt burden: its MIC status means it must borrow at IBRD rates, but its debt situation is preventing new lending, and the World Bank is largely inactive, though Jamaica is a pilot country for harmonisation. Nevertheless, in 2002, loans from IFIs totalled US$188m and bilateral grants totalled US$43.1m, a total of US$231.1m, i.e. 4.86 per cent of the Government of Jamaica's annual budget. Different perspectives on economic strategy mean that Jamaica does not have a current IMF programme, and the Government has been ambivalent towards formal donor coordination, being wary of mechanisms that might lead donors to "gang up" on it.

However, in the absence of a relationship with the IMF (a trigger for many donors' assistance), donors have persuaded government to produce a medium term socio-economic framework to set out its development priorities. This is built on government's existing plans, but these have been coordinated across the sectors and prioritised. Donors have begun to coordinate around this strategy, with the aim of focusing their assistance on government's priorities. The EU will use this framework as a trigger for release of €40m of direct budget support. The Ministry of Finance and Planning and a group of seven key aid agencies (DFID, World Bank, IADB, EC, UNDP, CIDA and USAID) agreed that this group should produce a model for strategic dialogue between the Ministry/PIOJ[16] and the aid agencies. It was also agreed with the Minister that discussions on prioritisation of aid should take place with the group, rather than on a bilateral basis. The need to ensure a properly harmonised effort is seen as so crucial to many

[16] Planning Institute of Jamaica.

international partners that CIDA, UNDP and the EC have all offered to provide assistance to PIOJ to strengthen their capacity to coordinate. There are also several examples of co-funding and a multi-donor effort to support reforms in public sector management.

In all four countries, the relationships between bilateral and multilateral agencies were particularly interesting, and we return to this theme in light of the discussion of aid agency choices which follows.

5.2 Aid agency choices

There are many dimensions to the choices that bilateral aid agencies make concerning their involvement with MICs. Which countries, and who in those countries, should benefit from assistance? Which channels should be used to deliver assistance? In which arenas (country-level, regional or global) should the donor operate? Should the current institutional framework for aid be taken as given, or should the donor try to modify it? And how much should the donor adapt to what other aid agencies are doing? Pro-active donors will be more aware of the potentials for competition and collaboration among agencies, and will consciously seek areas of comparative advantage that maximise the added value of their contribution.

5.2.1 Choosing beneficiary countries

With MICs drawing proportionately less aid than poorer countries, the dangers of spreading aid too thin become greater. Significant criteria for remaining involved in particular MICs include poverty and other development deficits (e.g. as revealed by the MDGs), country vulnerability (economic, social or political), historical relationships and accumulated country expertise (the positive aspects of inertia), public goods of special significance, the regional importance of some major MICs; and the scope for filling "gaps" left by other donors. Finally, there may be a sensible case for opting to provide aid to a MIC within a region or sub-region otherwise composed of LICs because of the economic and political significance of the close ties between the countries concerned. Whatever the reasons for the choice, donors simultaneously have to decide who within the country they particularly want to assist, and all these aspects will have a bearing on the choice of channels for delivering aid.

5.2.2 Aid channels

For bilateral donors the choices of aid channels are:

- Direct government to government aid.
- Indirect government to government aid via the intermediary of a multilateral organisation. (The EC provides aid collectively on behalf of EU members; bilaterals are shareholders in the MDBs and also collaborate in specific projects, through joint funding or by providing complementary TA.)
- Direct government to country (civil society/private sector) aid. In Colombia 50 per cent of total ODA flows through NGOs although it is not clear how much of this is via a donor country NGO and how much goes directly; it is highly fragmented aid that is excluded from consideration in the government's international cooperation plan, but assumes a particular importance when parts of the

country are beyond the reach of conventional government services. Even in less extreme circumstances (e.g. Bolivia) donors have to consider whether the government is sufficiently legitimate in the eyes of the poor people of the country to make it a credible recipient of donor assistance.

- Indirect government to country, via the intermediary of an NGO or other civil society organisation in the donor country (and sometimes matched with voluntary contributions from private citizens). Again, Colombia provides striking examples of strong connections between local and global civil society institutions, including the trades union movement and the Catholic Church.

Influencing processes for poverty reduction is neither sequential nor linear. There are antecedents to the donor-recipient relationship, to current understandings of the situation and to the aid instruments employed. While recognising the constraint that this history to the relationship may shape choice of aid channels, we propose that such a choice be informed by considering the questions proposed in the following table (Box 5.2) and that relate to the issues of power, voice and knowledge discussed in the previous section. (The same broad factors are also relevant for LICs, but the answers for MICs may be less straightforward, and the donor strategy many need to be more selective.)

Box 5.2 Relevant factors for choice of aid channels to support poverty reduction in MICs[17]

What changes in policy are we looking for?	Which forms of knowledge dominate this policy process? Whose knowledge is excluded? What are the principal storylines and key framing assumptions that shape policy in this area? What knowledge are we using? What are we ignoring?
How could the change happen?	Where are things happening that might have wider impact? Which actors operate in these spaces? Who is included and excluded?
Who could make it happen?	Who are the key actors associated with this policy process? Which actors are most powerful? Which are excluded? What kind of actor are we? How do we behave?
What do we need to do to make the desired change happen?	Does one engage with spaces dominated by the powerful, or add weight to the spaces of the powerless? How might different spaces be better connected?
How will we know if we have succeeded?	How can we track the process? How can we listen to what our partners tell us?

5.2.3 Lessons for effective aid to MICs

There are some tensions in the aid relationship that appear to be particularly striking in 'Middle Income Countries'. Many of the larger MICs have more complex and diverse institutions both within and outside government and donors can find themselves involved in internal political conflicts through the choice of whom they decide to associate with. A workshop with DFID staff in Latin America identified the following as significant lessons for effective aid (Hobley 2003):

17 Taken from Eyben (2004a). The questions in the left hand column originate from work by David Watson in Bangladesh.

- *Money* or *resource power* does help to get a seat at particular tables but not necessarily all the tables necessary to support effective change.
- *Position power* and resource power without the skills, competences and credibility is insufficient to build effective relationships.
- Relationships: often focus on those where there are *high levels of perceived comfort* i.e. working with other donors in coordination groups whilst missing more effective entry-points with other less obvious actors.
- *Long term investment in institutional relationships* with these other actors can support effective change even when little or no financial resources are transferred and high levels of spending may distract from the construction of effective relationships. Any relationship investment should be informed and tested by its capacity to support and not undermine poor people's empowerment.
- It is important to work on *demand-side issues as well as supply-side.* Past programmes, however, mainly focused on supply and improving supply-side relationships rather than building capability of people to articulate their demands, influence decision-making and access resources.
- The lesson that support to effective change through investing in relationships is much harder to achieve without a *country office* (staffed with senior personnel and delegated authority) applies equally to MICs.
- Donor knowledge of the *political, social and institutional policy context* is vital for effectiveness but they must consider who and how they finance for the acquisition of that knowledge and the impact this will have on their understanding of the structural causes of poverty.

5.3 Bilateral-multilateral relationships

5.3.1 General issues

It may be useful to consider aid providers to MICs in three groups: the MDBs, other multilaterals (principally the UN organisations and the EU), and bilateral donors. The IFIs have a particular concern over MICs – that they may lose them as clients if they no longer qualify for concessional aid and consider that they can borrow elsewhere with fewer strings attached. A major concern of the World Bank MIC task force was how to maintain a presence in non-borrowing MICs against the day when borrowing might again be required, and in order to maintain a global presence and provide intellectual services. The other multilaterals do not have to earn their presence in the MICs in the same way, and the bilaterals can, in principle, freely choose which countries they want to be involved in.

It is important to consider the interactions between these three groups of aid agencies:

(a) Bilaterals have advantages of flexibility and scope: they are inherently less rule-bound than multilateral organisations, and more able (though not necessarily more willing) to venture into the more political areas of aid. On the other hand, they are prone to spread themselves too thinly to have strong country-level representation, and may not sustain the kind of long-term relationships needed to address structural poverty in MICs.

(b) The MDBs of course have a vested interest in maintaining MIC demand for their services, but they may indeed have an advantage in certain areas, including aspects of policy advice, fiduciary assessments and support to public finance management. Their ability to maintain continuity and to draw on relevant regional and global experience can also be valuable, to the donor community as well as the country directly. Bilaterals (not least as MDB shareholders) should consider what continuing role the MDBs may usefully perform in MICs, and whether they should support that role financially (e.g. through trust funds or secondments).

(c) Both the MDBs and other bilaterals offer vehicles for collective action that may offset the fickleness and special interests of particular bilaterals. Indeed, as implied by our previous discussion concerning the capricious nature of bilateral aid, multilaterals may be a vehicle for moving global aid away from gift relationships and towards entitlements. Bilaterals should consider carefully the balance between their own direct efforts and resources channelled to MICs through multilaterals.

One means for channelling aid to 'Middle Income Countries' is to use bilateral technical assistance in conjunction with multilateral concessional lending 'to ensure that the international system works effectively for the elimination of poverty in 'Middle Income Countries''. This could mean supporting United Nations grant-giving organisations as well as the international finance institutions providing concessional loans. Some bilateral agencies have tended to be more interested in the latter, on the argument that it is the IFIs that manage the large financial resources. There are several issues associated with this choice:

- If structural and sustained poverty in 'Middle Income Countries' is not a product of absolute lack of resources but of internal distribution of these resources, then the provision of additional resources would not appear to be a solution to the problem; indeed, there is a considerable likelihood that these resources will be captured by the rich and powerful in the recipient country.
- The argument is that by close association with the IFIs a bilateral agency can ensure the additional resources are not captured in this way but are effectively used to reduce structural poverty. The implication of this argument is that without such efforts by a bilateral agency the IFIs by themselves would be less interested and/or effective at ensuring the resources were used in this way. Thus, the success of this strategy of close association with the development banks depends on the bilateral agency being able to influence the international finance institutions more than they are able to influence the agency. Banks necessarily have a supply driven relationship with Ministries of Finance; bilateral donors have the possibility of responding more flexibly and broadly to demands coming from many different sectors.

- A balance may need to be struck between channelling resources through the IFIs, with their often greater intellectual capacity and always greater resources, and through the United Nations system which potentially has more credibility and legitimacy with recipient governments and society, particularly with regard to the political issues that are inherent in tackling inequality, conflict and poverty.
- The focus on making the global system work better must be matched with a concern to support local efforts, bearing in mind that much real change, as distinct from paper-policy change, comes from ground-level action.

5.3.2 Country examples

Relationships between bilaterals and multilaterals were a significant issue in all four countries visited. *Bolivia*'s HIPC/PRSP framework was the environment in which bilateral/multilateral synergies are most easily captured, but the other countries were more problematic.

In *Colombia*, the MDBs (the World Bank, IADB and CAF) provided multi-billion dollar non-concessional lending to meet Colombia's fiscal gap of 2.8 per cent of GDP in 2003. The Banks also undertake important analytical work on taxation, corruption and studies to examine the costs of violence. The division between the urgent conflict-related agendas of security and rights and the longer-term sectoral development agenda is mirrored in a parallel split between bilateral and multilateral lending donors. The IADB, the World Bank and the UNDP are all involved in supporting the Government's efforts to produce a PRSP and to help the Government to report effectively on the MDGs in 2005. The Banks would welcome invitations to be more closely involved in the G24. Colombia could usefully extend the current human rights focus to include longer-term issues such as health and education and possibly more structural issues such as taxation. In this regard, the World Bank and the IADB knowledge and experience of the health and education sectors, derived through their lending operations, could be more closely brought into the mainstream of the G24 process and the bilaterals agree that closer involvement by the Multilateral Banks in the G24 dialogue would be welcomed. However there was no evidence to suggest that bilateral donors see the connection with their IFI Board representatives as avenues for influence or engagement in Colombia.

In *Peru***,** as in Colombia, non-concessional development finance, from both the World Bank and the IADB is important, but, as noted earlier, there is no institutional framework for strategic collaboration among government, multilaterals and bilaterals.

In *Jamaica,* the fact that the Government is unable, or unwilling, to access non-concessional funds may deprive it – and its grant-aid partners – of useful analytical support. There are also more immediate effects: the government has had to re-prioritise its loan-funded programmes – and those which it could not support with counterpart funds were suspended or cancelled. This had a knock-on effect on bilateral TA (Technical Assistance) programmes which were agreed on the assumption that the MDBs would provide the bulk of finance. The development of the Medium Term Social and Economic Framework

(MTSEF) is an attempt to provide a government-led focus for collaboration jointly with bilateral and multilateral partners. In purely financial terms, the multilaterals would seem to be alone in having some leverage over public policy. However, in practice, some strategic low-volume funding by grant donors is proving to have considerable impact on Government policy (e.g. funding the development of a White Paper on Public Sector Modernisation, and the funding of the Jamaica Social Policy Evaluation (JASPEV) that aims to ensure all Jamaican Government Ministries develop a pro-poor policy on specific issues such as youth exclusion.

6 Conclusion and further issues

This paper has discussed the various understandings of what is a 'Middle Income Country' and has explored the significance for aid to MICs in terms of global public good arguments as well as in relation to the problems of inequality and social exclusion in these countries. In considering what is donor good practice in a Middle Income Country we have argued that for such practice to be successful it must take into account the multiplex relations between donor and recipient governments that shape the motives and behaviour of both sides to the relationship as well as take into account those between and within multilateral and bilateral organisations.

In most 'Middle Income Countries' (MICs) there is not an overall and immediate and critical shortage of either human capital or financial resources. Aid as a proportion of GDP is usually modest, and consequently donors have little direct leverage. The role of donors must be to support the agenda of those local actors, government or otherwise, who are working for the kind of change that a donor judges worthwhile.

If a Middle Income Country has a track record of rapid improvement in the welfare of its population, aid may primarily be justified to speed things up, not only to increase welfare but also to expand the market for OECD (and LIC) goods and services as well as to build good international relations. Conversely, if no or little progress is being made, aid may be justified because of the very lack of progress in poverty reduction that may be due to deep structural inequalities and exclusion of much of the population. In this latter case, the choice of channels and instruments of aid may be rather different and great care should be taken to ensure that commercial and political interests of the donor government do not undermine the aid effort. When the purpose of aid is to reduce inequalities a donor may need to be there for the long haul with a commitment and preparedness to invest staff time in developing and maintaining institutional relationships. Finally, good aid practice needs to take account of the diversity among MICs and the significance of regional groupings that cut across the MIC-LIC divide. The case for specific, non-country based support to regional institutions should always be considered.

Coordinated aid mechanisms, such as Poverty Reduction Strategy Papers, developed primarily for Low Income Countries may not be appropriate (because the volume of aid does not justify the transaction costs involved) or acceptable (because of the general lack of donor leverage) or even useful to the recipients (because there may be different solutions to a complex and divergent development problem and different parts of the recipient government system may prefer to establish autonomous relations with separate donors).

Box 6.1 Relevance to the role of aid in MICs of lessons learnt from the CDF evaluation[18]

CDF lesson	Relevance to MICs
Donors should support efforts to strengthen budget processes and align their assistance with national development strategies	To the extent that MICs have stronger systems and higher capacity (not universally true) there is less reason for donors to bypass government systems in disbursing aid. However, MICs may be less willing to concede donor involvement in review of such systems, and in the formulation of national strategies. Donors should support national development strategies when these are credible, have broad-based support (particularly among poor people) and match donor objectives of poverty reduction.
Donors and recipient country bureaucracies should strengthen cross-sector dialogue and planning, and break down institutional sectoral silos	In non-aid dependent countries, recipient country bureaucracies are only likely to be interested in such a dialogue when there is clear evidence that it will help them do better what they are interested in. Less obvious "leverage" for donors puts a premium on understanding local interests and persuading rather than dictating (but this is supposed to be the PRSP paradigm too . . .)
Donors should work hard to integrate monitoring and evaluation activities into normal government (rather than donor) operations	Donors should particularly bear in mind the way that their resources are often appreciated by recipients as a means for supporting innovation and to pilot new approaches; as such the key point is that the learning and experience is widely disseminated and shared.
Donors should build on progress in increasing national ownership by broadening engagement with sectoral and regional authorities, elected officials and legislators, and with marginalised groups.	There may be both more need and more scope for such engagements in MICs, and bilateral donors may be well placed to pursue them.
Both donors and recipients need to change behaviour and processes to give up individual interests in order to achieve better development outcomes through joint action.	Bilateral aid to MICs is usually part of a more complex relationship between the two countries possibly involving political, security and commercial interests. The challenge for the donor agency is to seek to align all these interests in support of the poverty reduction objective.
Donors should try to address domestic political resistance to harmonising procedures, providing budget support and reducing the use of international consultants.	Budget support may not be an appropriate or welcome aid instrument in MICs. However, the general principles of harmonising procedures remain valid. Because of the higher levels of human capital in MICs there is even less justification for contracting large numbers of international staff.
Recipient countries should implement and enforce procurement and other accountability rules that will foster donor confidence	If the aid flows are relatively small, the incentive for such action is more likely to come from attracting FDI. However, promoting internationally acceptable fiduciary and governance standards is a legitimate collective concern of donors, and one where it makes sense to work closely with the IFIs.
Donors should avoid micro managing the country aid process and provide capacity building and resources recipients need to take the lead in aid management (e.g. by supporting the creation of independent country level aid review panels).	Donors need to design and manage the process in relation to the *raison d'être* for aid. As a general principle the balance of power between donor and recipient should be redressed by ceding more power to the latter.

18 The CDF lessons are from a summary made by Mark Lowcock , DFID Director General in an email to all DFID's country offices.

Much of what we have signalled as good practice in MICs may be equally relevant for donor practice in LICs, particularly the lessons learnt for effective aid in terms of investing in relationships. At the same time, there are also lessons for donor behaviour in MICs that we can draw on from the recent evaluation of the Comprehensive Development Framework where the focus was primarily on more aid dependent countries (World Bank 2003).

6.1 Issues for further exploration

The purpose of this paper has been to provoke discussion; we have challenged some of today's conventional wisdom relating to the purpose and practice of aid. We have suggested that aid coordination may not necessarily be the most helpful means to supporting recipient countries in solving complex problems and that there may not be a direct causal link between the amount of money provided and the magnitude of the impact achieved. With reference to the work of DFID in Brazil we have suggested that quite small interventions might have disproportionately significant effects. These ideas are drawn from complex adaptive systems approaches to public action (Groves and Hinton 2004; Chapman 2002; Rihani 2002) but as yet very little systematic work has been undertaken to explore the implications of such approaches in the aid relationship. Arguably, these kinds of approaches might be more relevant in the complex environment of those countries that are more integrated into the global political and economic system and where donor and recipient actors may be more multiplex and diverse in terms of role and motive.

One way of taking forward such an exploration would be to look for answers to the following questions in two regions of the world with different histories and motivations for the aid relationship, for example Central Asia and North Africa.

- Who benefits and who loses and in what circumstances from donor efforts at (internal – for example, Spain – as well as external) harmonisation – for example of procedures, goals, country analyses and aid instruments?
- What are the implications for a region or sub-region of varying patterns of aid to different countries within the region? How do vertical international aid activities (health, environment, drugs etc) integrate with national and regional agreements and strategies?
- How strategic are donor engagements and approaches (i.e. are donors prepared to build long-term relationships to tackle deep-seated problems)? How sensitive are they to local knowledge and unequal power relations and what difference does it make to their actions?
- What are the comparative advantages of MDBs, other multilaterals and bilaterals, and what does this imply about optimal channelling of aid?
- How important are (international and local) non-government channels for aid? How do donors engage with the (presumably) richer array of CSOs, academics etc in MICs?

- What influences donors' decisions regarding the proportion of money and staff they allocate to a particular recipient country and what would be recipients' preferences?

Annex A: Classifications of 'Middle Income Countries'

Introduction

This annex compares DAC, World Bank and HDR classifications, as they stood in 2003. Table A3 provides full details; Table A1 highlights discrepancies between what the DAC and the World Bank may call 'Middle Income Countries', while Table A2 shows asymmetries between income and HDI rankings. The following explanations of the DAC's aid recipient list and its aid definitions are taken from the OECD DAC website.

The DAC classification of aid recipients

This new List is still designed to capture all aid flows. However, only aid to "traditional" developing countries on Part I of the List counts as "official development assistance", for which there is a long-standing United Nations target of 0.7 per cent of donors' gross national product. Aid to the "more advanced" eastern European and developing countries on Part II of the List is recorded separately as "official aid".

The List is reviewed every three years. Countries above the World Bank High Income Country threshold for three consecutive years will normally progress to Part II of the List. However, exceptions can be made, and other countries may be transferred between Parts I and II, following consideration by the DAC of their development and resource status.

Thus, in DAC statistics, "developing country" means a country on Part I of the DAC List of Aid Recipients. Other organisations have their own definitions. The World Bank usually uses the term to refer to low and middle-income countries, assessed by reference to per capita GNP. This includes eastern European countries which are on Part II of the DAC List. The United Nations Conference on Trade and Development has different income thresholds from the World Bank, and includes some territories which are not on the DAC List. Other organisations often have a "developing country" category of membership, and use the term to refer to countries in that category.

DAC aid definitions

OFFICIAL AID (OA): Flows which meet conditions of eligibility for inclusion in OFFICIAL DEVELOPMENT ASSISTANCE (q.v.), other than the fact that the recipients are on Part II of the DAC List of Aid Recipients (see Recipient Countries and Territories). References to Official Development Assistance in this publication can be taken, mutatis mutandis, to apply to OFFICIAL AID.

OFFICIAL DEVELOPMENT ASSISTANCE (ODA): Grants or Loans to countries and territories on Part I of the DAC List of Aid Recipients (developing countries) which are: (a) undertaken by the official sector; (b) with promotion of economic development and welfare as the main objective; (c) at concessional financial terms (if a loan, having a Grant Element (q.v.) of at least 25 per cent). In addition to financial flows, Technical Cooperation (q.v.) is included in aid. Grants, Loans and credits for military purposes are excluded. Transfer payments to private individuals (e.g. pensions, reparations or insurance payouts) are in general not counted.

OFFICIAL DEVELOPMENT FINANCE (ODF): Used in measuring the inflow of resources to recipient countries: includes (a) bilateral ODA, (b) grants and concessional and non concessional development lending by multilateral financial institutions, and (c) Other Official Flows for development purposes (including refinancing Loans) which have too low a Grant Element (q.v.) to qualify as ODA.

Table A1: Discrepancies between DAC bands and World Bank MIC classification

	IDA only	IDA/IBRD blend	IBRD only
	"non-MICs"	*'Middle Income Countries'*	
LIC/LDC	Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cape Verde, Central African Republic, Chad, Comoros, Congo DR, Djibouti, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Laos, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Tanzania, Togo, Uganda, Vanuatu, Yemen, Zambia, Armenia, Cameroon, Congo, Rep., Côte d'Ivoire, East Timor, Georgia, Ghana, Kenya, Kyrgyz Rep., Moldova, Mongolia, Nicaragua, Tajikistan, Vietnam,	Azerbaijan, India, Indonesia, Nigeria, Pakistan, PNG, Uzbekistan, Zimbabwe	Equatorial Guinea
LMIC	Albania, Guyana, Honduras, Sri Lanka, Tonga,	Bolivia, Bosnia, Serbia, St Vincent,	Algeria, Belize, China, Colombia, Dominican Republic, Ecuador, Egypt, El Salvador, Fiji, Guatemala, Iran, Iraq, Jamaica, Jordan, Kazakhstan, FYR Macedonia, Marshall Is, Micronesia, Morocco, Namibia, Paraguay, Peru Philippines, South Africa, Swaziland, Syria, Thailand, Tunisia, Turkey, Turkmenistan, Belarus, Bulgaria, Romania, Russia, Ukraine
UMIC		Dominica, Grenada, St Lucia,	Botswana, Brazil, Chile, Costa Rica, Croatia, Gabon, Lebanon, Malaysia, Mauritius, Panama, Venezuela, Antigua, Argentina, Mexico, Palau, Seychelles, St Kitts, Trinidad, Uruguay
HIC			Korea Rep., Slovenia

Table A2 Asymmetries between income and HD grading 2003

HDR 2003 has only one example (Djibouti) with a HD rating lower than its income rating , but many (listed below) with HD one grade higher than income. The other countries are all have matching income and HD grades (the diagonal shaded boxes).

	Low HD	Medium HD	High HD
LIC		Bangladesh, Bhutan, Cambodia, Comoros, Equatorial Guinea, Laos, Lesotho, Madagascar, Myanmar, Sao Tome, Solomon Islands, Sudan, Togo,. Armenia, Azerbaijan, Congo Rep., Georgia, Ghana, India, Indonesia, Kyrgyzstan, Moldova, Mongolia, Nicaragua, PNG, Tajikistan, Uzbekistan, Vietnam Ukraine	
MIC	Djibouti		Cuba, Chile, Costa Rica, Croatia, Argentina, Barbados, Mexico, Seychelles, St Kitts, Trinidad, Uruguay Belarus, Czech Rep, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Malta
HIC			

Table A3 DAC, World Bank and HDR classifications 2003

DAC Classification as at 1 January 2003				World Bank Lending Eligibility as at 14 August 2003					Human Development Report 2003 (same brackets for High, Middle and Low Income as DAC)			PRSP
	Population (millions 2001, from WDI)	2001 if different	2003	GNI per capita (US$)	Income Category	IBRD only	Blend	IDA only	HDI rank	Low, Medium, High Human Development	Low, Medium, High Income	PRSP or I-PRSP prepared
Part I: Developing Countries and Territories (Official Development Assistance)												
1. Least Developed Countries (LDCs)												
Afghanistan	27.2		1	NA	I			X	NA		L	
Angola	13.5		1	660	I			X	164	L	L	
Bangladesh	133.3		1	360	I			X	139	M	L	
Benin	6.4		1	380	I			X	159	L	L	
Bhutan			1	590	I			X	136	M	L	
Burkina Faso	11.6		1	220	I			X	173	L	L	
Burundi	6.9		1	100	I			X	171	L	L	
Cambodia	12.3		1	280	I			X	130	M	L	
Cape Verde			1	1,290	II			X	103	M	M	
Central African Republic	3.8		1	260	I			X	168	L	L	
Chad	7.9		1	220	I			X	165	L	L	
Comoros			1	390	I			X	134	M	L	
Congo, Dem.Rep.	52.4		1	90	I			X	167	L	L	
Djibouti			1	900	II			X	153	L	M	
Equatorial Guinea			1	NA	I	X			116	M	L	
Eritrea	4.2		1	160	I			X	155	L	L	
Ethiopia	65.8		1	100	I			X	169	L	L	
Gambia	1.3		1	280	I			X	151	L	L	
Guinea	7.6		1	410	I			X	157	L	L	
Guinea-Bissau	1.2		1	150	I			X	166	L	L	
Haiti	8.1		1	440	I			X	150	L	L	
Kiribati			1	810	II			X	NA		M	
Laos	5.4		1	310	I			X	135	M	L	
Lesotho	2.1		1	470	I			X	137	M	L	
Liberia	3.2		1	150	I			X	NA		L	
Madagascar	16.0		1	240	I			X	149	M	L	
Malawi	10.5		1	160	I			X	162	L	L	
Maldives			1	2,090	III			X	86	M	M	
Mali	11.1		1	240	I			X	172	L	L	
Mauritania	2.7		1	340	I			X	154	L	L	
Mozambique	18.1		1	210	I			X	170	L	L	
Myanmar	48.3		1	NA	I			X	131	M	L	
Nepal	23.6		1	230	I			X	143	L	L	
Niger	11.2		1	170	I			X	174	L	L	
Rwanda	8.7		1	230	I			X	158	L	L	
Samoa			1	1,420	III			X	70	M	M	
Sao Tome and Principe			1	290	I			X	122	M	L	
Senegal	9.8		1	470	I			X	156	L	L	
Sierra Leone	5.1		1	140	I			X	175	L	L	
Solomon Islands			1	570	I			X	123	M	L	
Somalia	9.1		1	NA	I			X	NA		L	
Sudan	31.7		1	350	I			X	138	M	L	
Tanzania	34.4		1	280	I			X	160	L	L	
Togo	4.7		1	270	I			X	141	M	L	
Tuvalu			1						na		NA	
Uganda	22.8		1	240	I			X	147	L	L	
Vanuatu			1	1,080	II			X	128	M	M	
Yemen	18.0		1	490	I			X	148	L	L	
Zambia	10.3		1	330	I			X	163	L	L	
2. Other Low Income Countries (LICs) (per capita GNI <$745 in 2001)												
*Armenia	3.8		2	790	II			X	100	M	L	
*Azerbaijan	8.1		2	710	I		X		89	M	L	
Cameroon	15.2		2	560	I			X	142	L	L	
Congo, Rep.	3.1		2	700	I			X	140	M	L	
Côte d'Ivoire	16.4		2	610	I			X	161	L	L	
East Timor			2	430	I			X	NA		L	
*Georgia	5.3	3	2	720	I			X	88	M	L	
Ghana	19.7		2	270	I			X	129	M	L	
India	1032.4		2	480	I		X		127	M	L	
Indonesia	209.0		2	710	I		X		112	M	L	
Kenya	30.7		2	360	I			X	146	L	L	
Korea, Democratic Republic	22.4		2						NA		L	
*Kyrgyz Rep.	5.0		2	290	I			X	102	M	L	
*Moldova	4.3		2	480	I			X	108	M	L	
Mongolia	2.4		2	440	I			X	117	M	L	
Nicaragua	5.2		2	NA	I			X	121	M	L	
Nigeria	129.9		2	290	I		X		152	L	L	
Pakistan	141.5		2	410	I		X		144	L	L	
Papua New Guinea	5.3	3	2	530	I		X		132	M	L	
Tajikistan	6.2		2	180	I			X	113	M	L	
*Uzbekistan	25.1	3	2	460	I		X		101	M	L	
Viet Nam	79.5		2	430	I			X	109	M	L	
Zimbabwe	12.8		2	NA	I		X		145	L	L	

DAC Classification				World Bank Lending Eligibility					HDR 2003			PRSP
	Population (millions 2001, from WDI)	2001 if different	2003	GNI per capita (US$)	Income Category	IBRD only	Blend	IDA only	HDI rank	Low, Medium, High Human Development	Low, Medium, High Income	PRSP or I-PRSP prepared
3. Lower Middle Income Countries (LMICs) (per capita GNI $746--$2975 in 2001)												
*Albania	3.2		3	1,380	II			X	95	M	M	
Algeria	30.8		3	1,720	III	X			107	M	M	
Belize			3	2,960	IV	X			67	M	M	
Bolivia	8.5		3	900	II		X		114	M	M	
Bosnia and Herzegovina	4.1		3	1,270	II		X		66	M	M	
China	1271.8	2	3	940	II	X			104	M	M	
Colombia	43.0		3	1,830	III	X			64	M	M	
Cuba	11.2		3						52	**H**	**M**	
Dominican Republic	8.5		3	2,320	III	X			94	M	M	
Ecuador	12.9		3	1,450	III	X			97	M	M	
Egypt	65.2		3	1,470	III	X			120	M	M	
El Salvador	6.4		3	2,080	III	X			105	M	M	
Fiji			3	2,160	III	X			81	M	M	
Guatemala	11.7		3	1,750	III	X			119	M	M	
Guyana			3	840	II			X	92	M	M	
Honduras	6.6	2	3	920	II			X	115	M	M	
Iran	64.5		3	1,710	III	X			106	M	M	
Iraq	23.8		3	NA	II	X			NA		M	
Jamaica	2.6		3	2,820	III	X			78	M	M	
Jordan	5.0		3	1,760	III	X			90	M	M	
*Kazakhstan	14.9		3	1,510	III	X			76	M	M	
Macedonia (FYR)	2.0		3	1,700	III	X			60	M	M	
Marshall Islands			3	2,350	III	X			NA		M	
Micronesia, Federated States			3	2,150	III	X			NA		M	
Morocco	29.2		3	1,190	II	X			126	M	M	
Namibia	1.8		3	1,900	III	X			124	M	M	
Niue			3						NA			
Palestinian Administered Areas	3.1		3						98	M	M	
Paraguay	5.6		3	1,170	II	X			84	M	M	
Peru	26.3		3	2,050	III	X			82	M	M	
Philippines	78.3		3	1,020	II	X			85	M	M	
Serbia & Montenegro	10.7		3	1,400	II		X		NA		M	
South Africa	43.2		3	2,600	III	X			111	M	M	
Sri Lanka	18.7		3	840	II			X	99	M	M	
St Vincent & Grenadines			3	2,820	III		X		80	M	M	
Suriname			3	1,960	III	X			77	M	M	
Swaziland	1.1		3	1,180	II	X			133	M	M	
Syria	16.6		3	1,130	II	X			110	M	M	
Thailand	61.2		3	1,980	III	X			74	M	M	
! Tokelau			3						NA			
Tonga			3	1,410	II			X	NA		M	
Tunisia	9.7		3	2,000	III	X			91	M	M	
Turkey	66.2	4	3	2,500	III	X			96	M	M	
*Turkmenistan	5.4		3	1,200	II	X			87	M	M	
! Wallis and Futuna			3						NA			
4. Upper Middle Income Countries (UMICs) (per capita GNI $2976--9205)												
Botswana	1.7		4	2,980	IV	X			125	M	M	
Brazil	172.4		4	2,850	III	X			65	M	M	
Chile	15.4		4	4,260	IV	X			43	**H**	**M**	
Cook Islands			4						NA			
Costa Rica	3.9	3	4	4,100	IV	X			42	**H**	**M**	
Croatia	4.4		4	4,640	IV	X			47	**H**	**M**	
Dominica		3	4	3,180	IV		X		68	M	M	
Gabon	1.3		4	3,120	iv	x			118	M	M	
Grenada			4	3,500	IV		X		93	M	M	
Lebanon	4.4		4	3,990	IV	X			83	M	M	
Malaysia	23.8		4	3,540	IV	X			58	M	M	
Mauritius	1.2		4	3,850	IV	X			62	M	M	
! Mayotte			4						NA			
Nauru			4						NA			
Panama	2.9		4	4,020	IV	X			59	M	M	
! St Helena			4						NA			
St Lucia			4	3,840	IV		X		71	M	M	
Venezuela	24.6		4	4,090	IV	X			69	M	M	
4+. Threshold for World Bank Loan Eligibility ($5185 in 2001)				80								
! Anguilla			4+						NA			
Antigua and Barbuda			4+	9,390	V	X			56	M	M	
Argentina	37.5		4+	4,060	IV	X			34	**H**	**M**	
Barbados			4+						27	**H**	**M**	
Mexico	99.4	4	4+	5,910	V	X			55	**H**	**M**	
! Montserrat			4+						NA			
Oman	2.5		4+						79	M	M	
Palau Islands		4	4+	7,140	V	X			NA		M	
Saudi Arabia	21.4		4+						73	M	M	
Seychelles			4+	NA	V	X			36	**H**	**M**	
St Kitts and Nevis			4+	6,370	V	X			51	**H**	**M**	
Trinidad and Tobago	1.3	4	4+	6,490	V	X			54	**H**	**M**	
! Turks and Caicos Islands			4+						NA			
Uruguay	3.4	4	4+	4,370	IV	X			40	**H**	**M**	
5. High Income Countries (HICs) (per capita GNI >$9206 in 2001)												
Bahrain		4+	5						37	H	H	

DAC Classification				World Bank Lending Eligibility					HDR 2003			PRSP
	Population (millions 2001, from WDI)	2001 if different	2003	GNI per capita (US$)	Income Category	IBRD only	Blend	IDA only	HDI rank	Low, Medium, High Human Development	Low, Medium, High Income	PRSP or I-PRSP prepared
Part II: Countries and Territories in Transition (Official Aid)												
6. Central and Eastern European Countries and New Independent States of the former Soviet Union (CEECs/NIS)												
*Belarus	10.0		6	1,360	II	X			53	H	M	
*Bulgaria	8.0		6	1,790	III	X			57	M	M	
*Czech Republic	10.2		6	5,560	V	X			32	H	M	
*Estonia	1.4		6	4,140	IV	X			41	H	M	
*Hungary	10.2		6	5,280	V	X			38	H	M	
*Latvia	2.4		6	3,480	IV	X			50	H	M	
*Lithuania	3.5		6	3,660	IV	X			45	H	M	
*Poland	38.6		6	4,570	IV	X			35	H	M	
*Romania	22.4		6	1,850	III	X			72	M	M	
*Russia	144.8		6	2,140	III	X			63	M	M	
*Slovak Republic	5.4		6	3,950	IV	X			39	H	M	
*Ukraine	49.1		6	770	II	X			75	M	L	
7. More Advanced Developing Countries and Territories												
! Aruba			7						NA			
Bahamas			7						49	H	H	
! Bermuda			7						NA			
Brunei			7						31	H	H	
! Cayman Islands			7						NA			
Chinese Taipei			7						NA			
Cyprus			7						25	H	H	
! Falkland Islands			7						NA			
! French Polynesia			7						NA			
! Gibraltar			7						NA			
! Hong Kong, China	6.7		7						26	H	H	
Israel	6.4		7						22	H	H	
Korea, Republic	47.3		7	9,930	V	X			30	H	H	
Kuwait			7						46	H	H	
Libya	5.4		7						61	M	M	
! Macao			7						NA			
Malta		5	7						33	H	M	
! Netherlands Antilles			7						NA			
! New Caledonia			7						NA			
Qatar			7						44	H	H	
Singapore	4.1		7						28	H	H	
Slovenia	2.0	5	7	9,810	V	X			29	H	H	
United Arab Emirates	3.0		7						48	H	H	
! Virgin Islands (UK)			7						NA			

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