SUMMARY REPORT

Workshop for Middle Income Countries

Preparing for the 2017 Financing for Development Forum

May 2017

- Income boundaries are arbitrary and limited, antiquated and inconsistent thresholds that delegitimize the impact of poverty and block otherwise eligible countries from receiving concessional financing.

- MICs represent the majority of countries (105) and contain the majority of world poverty (71%) and population (~75%). Many of these countries have substantial development needs and challenges not wholly dissimilar than low income countries. The term MICs is an uninformative catch-all whose wide range of countries cover the majority share of world population.

- Economic transformation should be measured using a multi-dimensional approach that takes into account the varying impacts of different development needs, development vulnerabilities, development capabilities and; economic shocks, trade shocks, environmental shocks, productivity shocks.

- Intelligent and targeted engagement on this issue is critical – therefore, engagement on the issues facing MICs, not the terminology, is essential.

- Mandates of the multilateral institutions must be updated; considering that principles of universality and complementarity are our focus, yet we continue to deal with the limitation of categorizing based exclusively by income.

1.Concept

Middle income countries (MICs) face an intractable identity problem: what exactly is a "middle income country"? This categorization focuses on income per capita as the main factor for defining groups of countries and for allocating the financial resources for development cooperation. Classifying countries this way ties in with the development narrative that countries take responsibility for their own development once they "graduate" from low income status.

The problem is that the income boundaries between groups of countries are defined inconsistently across development institutions and are unidimensional, failing to account for multidimensional poverty, complex economic and social inequalities, and for the fact that many countries graduate to "middle income" status only to slip back into a "lower income" group once official development assistance (ODA) is taken away.[1] This last phenomenon reveals that "graduation" may reflect only marginal changes in economic conditions and not genuine economic transformation.

The consequences for progress on a sustainable development agenda are far reaching. Middle income countries are systemically important for global growth and for economic and financial stability, so ODA should not be regarded as a zero sum game. Thought leaders on international cooperation for development finance are well advised to prioritize the structural problems experienced by the MICs for the sake of all countries.

To help countries designated as "middle income" prepare for the 2017 Financing for Development Forum and other upcoming UN fora, the Friedrich-Ebert-Stiftung New York (FESNY) convened a workshop for Member States in New York on May 9, 2017. The discussion, held under Chatham House Rule and guided by outside economic experts, helped middle income countries to identify critical concerns toward developing their own agenda.

[1] Economic Commission for Latin America and the Caribbean (2011). "Financing for development and middle income-countries: new challenges", Page 7. LC./L.3419, November 2011, United Nations.

2. Summary of the Discussion

Economic transformation should be measured based on a multi-dimensional approach. The UN system and the International Financial Institutions (IFIs) must work together to establish more complex yet transparent and fair mechanisms that better reflect MICs diverse realities, by defining system-wide guidelines and criteria.

The concept of MICs originated as an internal institutional process of the World Bank Group (WBG)[2]. The moorings behind it have very little relevance today. Arguments for this can be found in a 1989 WBG working paper reviewing the application categories, which asserts that these categories do not provide a complete overview of countries' development progress and level of vulnerability.

MICs are in fact far from "middleness" in terms of numbers, poverty levels, and populations. While Low income countries house only 8.69% of the world population, approximately 75% of the population is in Low-Middle-Income and Upper-Middle-Income countries which, without including China and India, represent approximately 50% of world population. The median income of Lower-Middle income countries is a few hundred dollars away from the lower threshold of least-developed countries. When we refer to MICs we are not referring to the middle class – these countries face high levels of poverty and vulnerability.

Establishing new categories that are based on multiple criteria, including the Least Developed Country (LDC) category, is a good new practice to which the UN system and the IFIs can turn. Solutions must be simple enough to be absorbed and applied but should not be so simple as to revert back to the problem. The UNDP Latin American and Caribbean 2016 Human Development Index (HDI) report provides examples of alternative solutions. The report, going country-by-country, shows that most Latin American and Caribbean (LAC) countries are not middle class – they are in fact poor or in high vulnerability situation.

Countries that have graduated from the LDC category must struggle to deal with their own financing. ODA,

[2] World Bank (1989). "Per Capita Income". IBRD SecM89-73, January 17, 1989.

preferred trading, and debt sustainability support are just some of the financing mechanisms of which middle income countries are deprived. Due to the simplicity of the income classification scheme, it is common for country classifications to change. LDCs can graduate from this category, but if they lose access to sufficient international development aid, they are automatically placed at risk of seeing their development efforts reverted, without being formally demoted back to the LDC category. This is known as the MIC trap. More structured, multi-dimensional criteria on country-specific contexts would not see the same volatility as does the present criteria.

The World Bank has three lending categories: International Development Association (IDA)-only, IDA-(blend) and International Bank of Reconstruction and Development (IBRD). The consequences of graduating from the IDA category include a loss not only of preferential IDA funding, but also of concessional financing from other donors whose policies may be tied to the IDA income threshold for IDA eligibility. Furthermore, bilateral donors could interpret IDA graduation in two ways – either the graduated country needs more financing to compensate for the loss of IDA or the graduated country is no longer in a situation of high risk or in urgent need of funding. Often the second scenario is the case, and therefore the graduated country depends more on financing from market sources, which expose the borrower to the volatile movements of the market.

The underlying criteria for graduation are creditworthiness and GNI / capita. Creditworthiness is based on political risk, external debt and liquidity, fiscal policy and public debt burden, balance of payment risks, economic structure and growth prospects, monetary and exchange rate policy, financial sector risks, and corporate sector debt. The actual “readiness” to graduate is based on an assessment of a country’s macroeconomic prospects, risk of debt distress, vulnerability to shocks, external debt and liquidity, political stability and levels of poverty and social indicators.

Political realism is crucial. A MIC strategy should highlight the context of MICs without jeopardizing the positions of other categories. Messaging should articulate the non-competitive intention of the group not to take away from groups classified differently. Thought must be given to the context of High-Income countries: How do they become advantaged? How can we find a benefit for all Member States?

Consensus within the MICs countries is crucial for developing a coherent and effective system of advocacy. Countries classified as Upper-Middle-Income may see their privileges as developing countries at risk of being undermined or withdrawn, primarily those related to trade. Others with access to concessional financing and other financial privileges may react with concern towards the possibility of having to share limited ODA with a larger number of beneficiaries. A common understanding of principles, priorities and challenges as well as cooperation of all interested parties is crucial to promote actions in favor of MICs.

Developmental gaps exist when resources are not employed where and how they are most needed. Diverting funding from where it is most needed results in increased development costs for affected countries. Ensuring the quality and effectiveness of aid is crucial. Mechanisms must be in place to ensure that aid is going where it is needed most and to those most in need.

MICs should be creative in identifying mechanisms to increase the volume of funding and interdependence amongst them. One option could be to begin lending to each other by mobilizing funding used to address economic shocks trapped in reserves. MICs could use this funding to borrow from each other.

Concessional financing is not the only issue for which MICs require support from the development community and mainly from the UN system and the IFIs. Technical assistance, mediator, broker, et cetera, are a few examples. Furthermore, the UN system should consider how to enhance capacity building, knowledge transfer and technology transfer within MIC countries.

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