Financing for development and middle income-countries: new challenges

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An earlier version of this document was presented by the Economic Commission for Latin America and the Caribbean at the Latin American and Caribbean Regional Consultation on Financing for Development, held in Santiago from 10-11 August 2011.

LC./L.3419 • November 2011

2011-601

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EXECUTIVE SUMMARY

A criterion commonly used to classify countries, including by the donor countries of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development, focuses on income per capita as the main factor for defining groups of countries.

Classifying countries according to income level ties in with the idea that countries should assume responsibility for their own development after reaching a certain income level (a process known as "graduation"). However, there are many important consequences of using arbitrary income boundaries to define categories.

First, and this is especially true for borderline countries, graduation may simply be triggered by marginal changes in economic conditions, but it can lead to important changes in the development assistance environment, including the amount of assistance delivered and the conditions —greater or lesser concessionality— in which that assistance is delivered.

Second, the process of graduation into the next higher income category is not a linear one, with countries often slipping back into a previous income status. This is another reflection of the fact that graduation may not be a sign of fundamental changes in a country's development reality but simply of marginal changes in economic conditions.

Finally, and most importantly, using income thresholds leads to country groupings that do not capture the complex nature of development and the diversity of situations among and within the members of each group. In particular, middle-income countries (MICs) —considered as a group— constitute an essential pillar of the world economy, they account for a large share of economic activity and trade, and they are home to a majority both of the world's population and of the world's poor. However, a closer look inside the group reveals striking heterogeneity among the various individual countries. The wide range of capacities and needs among MICs is not taken into account when countries are grouped simply by income level.

In Latin America and the Caribbean, almost 90% of countries fall in the middle-income category. The disparities across these countries are found in a wide range of variables relating not only to size and economic conditions but also to social situation and structural features linked to development potential and productive performance.

This broad diversity of capacities and needs among MICs is, however, seldom taken into account by donor countries and multilateral agencies when prioritizing the allocation of official development assistance (ODA). The rationale for ODA allocation in recent decades has been to channel the bulk of ODA towards low-income countries, including those classified as least developed countries (LDCs), to the detriment of MICs. The thinking is that since MICs have higher average incomes, their needs should be less.

For a middle-income region such as Latin America and the Caribbean, this has meant that its share of ODA flows fell from an already low 9% in 1990 to an even lower 7% in 2009, compared with Africa and Asia which receive the most substantial share (37% and 30% respectively).

Although it is to be expected that the international system of cooperation should focus on levelling the playing field for low-income economies and narrowing their development gap with respect to the more advanced countries, international cooperation mandates should not be limited to that focus. International cooperation should search for a comprehensive and broad-based response to the development problem, one that not only addresses the needs of low-income countries but also considers the diverse needs and kinds of vulnerability present in MICs.

For this, it is vital to have a comprehensive understanding of where the major needs and areas of vulnerability lie in each case and where the main gaps are between needs and possibilities so that development assistance may be allocated accordingly.

A crucial step forward in this direction would be the revision of the criteria used for country classification and the substitution of the currently used income-based criteria with new, better-suited indicators. These new indicators should be able to capture the multifaceted nature of development and thus lead to country groupings that are less heterogeneous internally.

More specifically, these indicators should reflect structural challenges and areas of vulnerability that are present in MICs but not captured by income per capita thresholds. In the case of Latin American and Caribbean MICs, these traditional long-term challenges and areas of vulnerability can be summarized in what the Economic Commission for Latin America and the Caribbean identified as key gaps that must be closed in order to avert the "middle-income trap" and move towards a sustainable and dynamic development process that places equity at its centre (ECLAC, 2010a). Those gaps are the financing gap, the inequality and social protection gap, the human capital gap and the productivity and investment gap.

Besides developing better criteria for ODA allocation, the international community must persist in the effort to increase the resources available for development financing. The current level of ODA financing provided to developing countries is clearly insufficient; and as a result, increases in assistance to some countries or regions sometimes occur at the expense of others (such as some MICs) that also have important needs.

Despite efforts by DAC donor countries to increase the amount of ODA provided, the levels in 2010 stood at only 0.32% of GNI on average, far behind the internationally agreed target of 0.7%. In addition, the public finances of many donors deteriorated substantially in the wake of the global crisis, making the scaling up of development assistance levels less likely. As the post-crisis scenario has added new areas of vulnerability to the traditional ones faced by some developing countries, the tension will persist between scarce resources and vast needs.

It is therefore of vital importance that the international community pool efforts to come up with innovative ways of mobilizing resources for development that supplement —not replace— ODA flows. Countries of both the northern and southern hemispheres have joined forces on different occasions to develop innovative finance for development mechanisms. The proposals range from specific types of global taxes to mechanisms that facilitate private, person-to-person voluntary donations. Some of these proposals are already being implemented and the results are encouraging. Nevertheless, much remains to be done in this area and the international community should invest seriously in efforts to that end.

A. MIDDLE-INCOME COUNTRIES AND THEIR RELEVANCE IN THE GLOBAL SETTING

1. Defining middle-income countries

A criterion commonly used to classify countries, including by the donor countries of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), focuses on income per capita as the main factor for defining groups of countries.

Classifying countries according to income level ties in with the idea that countries should assume responsibility for their own development after reaching a certain income level (a process known as "graduation"). This can have significant repercussions for countries close to the cut-off points, as the assigned category can have an impact not only on the amount of development assistance received but also on the conditions in which that assistance is delivered (greater or lesser degree of concessionality). In other words, marginal changes in a country's situation could lead to graduation and that, in turn, could trigger important changes in terms of the country's development assistance environment (Eiben and Lister, 2004).

Moreover, the process of graduation to the next higher income category is not a linear one, with countries often slipping back into a previous income status.[1] This is another reflection of the fact that graduation to the next income level may not be a sign of fundamental changes in a country's development reality but simply of marginal changes in economic conditions.

Finally, and most importantly, using income thresholds leads to country groupings that do not capture the complex nature of development and the diversity of situations among and within the members of each group. In particular, middle-income countries (MICs) —considered as a group— constitute an essential pillar of the world economy, they account for a large share of economic activity and trade, and they are home to a majority both of the world's population and of the world's poor. However, a closer look inside the group reveals broad heterogeneity among the various individual countries. The wide range of capacities and needs among MICs is not taken into account when the countries are grouped simply by income level (Pérez-Caldentey, Titelman and Vera, 2011).

2. Relevance of middle-income countries in the global setting

More than half of the world's countries are situated in the middle-income category and these countries are home to more than 70% of the world's population. MICs are found in all developing regions of the world, with Latin America and the Caribbean having the highest proportion of MICs worldwide (28% of the world total) and regionally (almost 90% of this region's countries fall in the middle-income category).[2]
MICs have become a growing economic force over time. For example, between 1980 and 2009 their share of world GDP increased from 20% to 26% and their share in world exports of goods and services increased from 17% to 28% (see figure 1).

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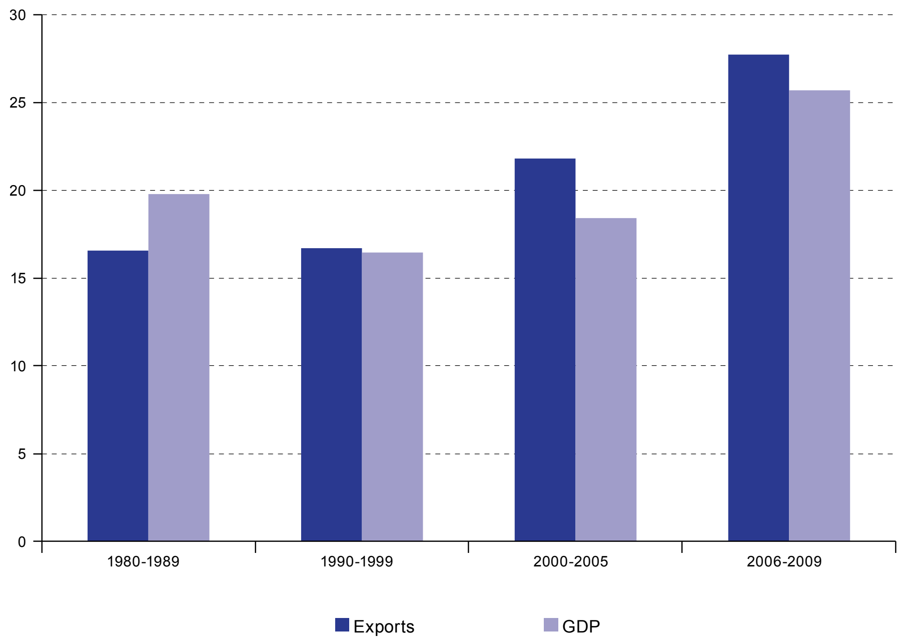
1 For example, Eyben and Lister (2004) reported that, in the preceding 20 years, 38 countries had reverted from middle-income back to low-income status, with only 10 of them managing to return to middle-income status in subsequent years.

2 This section uses the World Bank classification and considers 33 countries of Latin America and the Caribbean.

Figure 1
MIDDLE-INCOME COUNTRIES: WORLD SHARE OF GDP AND EXPORTS, 1980-2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators [online database] http://devdata.worldbank.org/dataonline.

Note: Figures refer to current GDP and exports of goods and services in United States dollars.

At the same time, the rising economic importance of MICs has been accompanied by a shift in the global distribution of the poor. Recent estimates by Sumner (2010) show that, at the end of the 1980s, 7% of the world's poor (121 million people) lived in MICs. By 2008, the level had risen to 72% (957 million) if China and India are included in the MIC group. Even if those two countries are not included, the increase was still significant, at 22% (more than three times the earlier figure).

B. MIDDLE-INCOME COUNTRIES WITHIN THE SYSTEM OF INTERNATIONAL COOPERATION

1. Disparities among middle-income countries in terms of needs and possibilities

The significance of the MIC group in the world economy should not eclipse the fact that this is a very heterogeneous group with huge disparities among and within its members in terms of needs and possibilities. The disparities are found in a wide range of variables related not only to size and economic conditions but also to social situation and structural features linked to development potential and productive performance.

In terms of income per capita, for example, the disparities among MICs at the global level are glaring. For the group of countries ranked as lower middle-income, GDP per capita ranges from a minimum of US$ 727 to a maximum of US$ 6,563; and for the group of upper middle-income countries, it varies between a minimum of US$ 4,170 and a maximum of US$ 17,954.

The disparities are also very marked with regard to social conditions, as can be seen in the indicators measuring poverty and inequality levels. The poverty rate for the lower middle-income country group varies between a minimum of 2.5% and a maximum of 83.9%, and the Gini index ranges from a minimum of 28 to a maximum of 58.6. For the upper middle-income group, the poverty rate varies between a minimum of 2% and a maximum of 42.9%, and the Gini index between 26.7 and 58.3 (see table 1).

Table 1

MIDDLE-INCOME COUNTRIES WORLDWIDE: PER CAPITA INCOME, GINI INDEX AND POVERTY RATE

(United States dollars and percentages, averages for 2000-2009)

Variable	Number of observations	Mean	Standard deviation	Minimum	Maximum
Lower middle-income countries					
GDP per capita (US$)	52	3 294	1 405	727	6 563
Gini index	40	43.5	8.1	28.0	58.6
Poverty rate (%)	39	43.8	22.1	2.5	83.9
Upper middle-income countries					
GDP per capita (US$)	44	9 295	2 905	4 170	17 954
Gini index	29	42.2	9.9	26.7	58.3
Poverty rate (%)	30	11.0	9.2	2	42.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators [online database] http://devdata.worldbank.org/dataonline.

Note: The figures refer to GDP per capita measured in purchasing power parity (in constant 2005 international dollars) and the poverty rate using a poverty line of two dollars per day. The Gini index is used to measure income inequality and ranges between a minimum of 0 (lowest inequality) and a maximum of 100 (highest inequality). The classification of countries by income group is based on the latest classification of the World Bank.

At the regional level, the MICs of Latin America and the Caribbean replicate the pattern found at the global level. In terms of per capita income, the group of countries ranked as lower middle-income exhibit a difference of roughly US$ 4,000 between the lowest and highest values (US$ 2,296 and US$ 6,537). In the group of upper middle-income countries, per capita income varies between US$ 5,847 and US$ 16,026 (see table 2).

Poverty rates in turn vary from 10.4% in Uruguay (UMIC) to 68.9% in Honduras (LMIC) according to ECLAC data for the region (see figure 2).

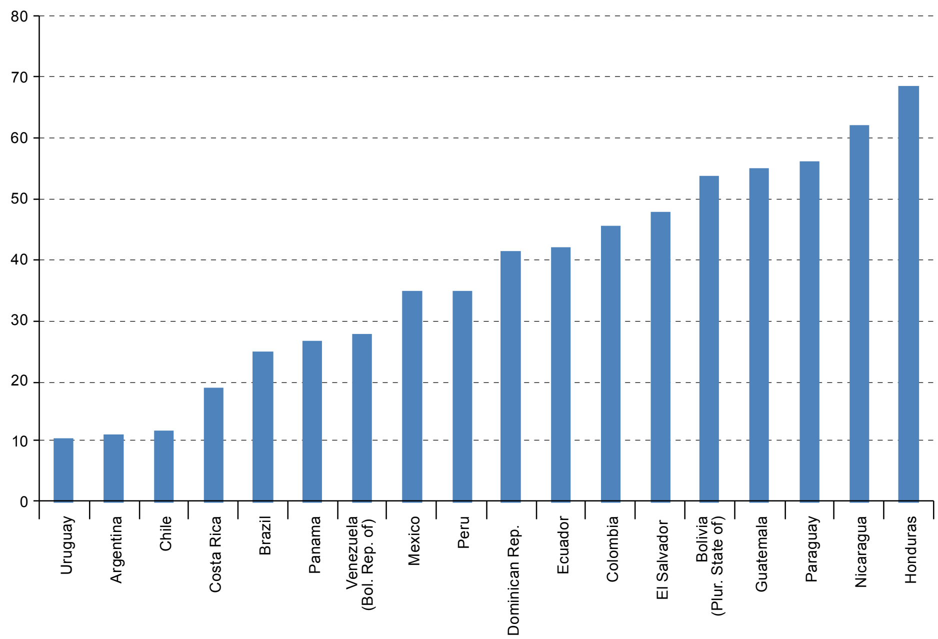
Table 2
MIDDLE-INCOME COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN: PER CAPITA INCOME
(Untied States dollars, averages for 2000-2009)

Variable	Number of observations	Mean	Standard deviation	Minimum	Maximum
Lower middle-income countries					
GDP per capita	9	4 231	1 532	2 296	6 537
Upper middle-income countries					
GDP per capita	19	9 196	2 675	5 847	16 026

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators [online database] http://devdata.worldbank.org/dataonline.

Note: The figures refer to GDP per capita measured in purchasing power parity (in constant 2005 international dollars). The classification of countries by income group is based on the latest classification of the World Bank.

Figure 2
LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): POVERTY RATE BY COUNTRY, 2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America 2010* (LC/G.2481-P), Santiago, Chile, 2010. United Nations publication, Sales No. E.11.II.G.6.

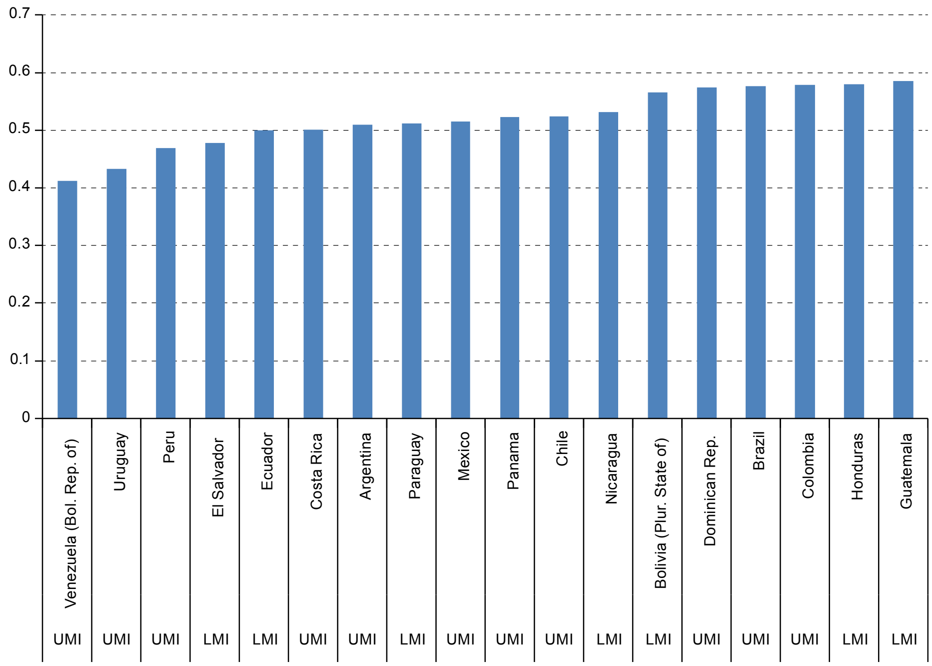
Note: The data correspond to 2009 or the most recent year available. Poverty rates refer to national averages or urban areas when data at the national level were not available.

Although the poverty rate is on average higher for the lower middle-income countries than for the upper middle-income countries of the Latin American region the association is not necessarily linear and countries with higher income levels may have significant pockets of poverty that are more severe than countries with lower income levels. In fact, a look at the overall poverty figures shows that almost 50% of Latin America's 183.5 million poor live in only two countries, which are classified as upper middle-income countries: Brazil (26%) and Mexico (23%).

A similar situation is observed with regard to inequality levels. Inequality is not consistently associated with lower relative income levels. As shown in figure 3 below, both upper and lower middle-income countries can be found at either end of the inequality spectrum of Latin American countries.

Figure 3

LATIN AMERICA AND THE CARIBBEAN (SELECTED COUNTRIES): GINI INDEX BY COUNTRY AND INCOME CATEGORY, 2009



Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America 2010* (LC/G.2481-P), Santiago, Chile, 2010. United Nations publication, Sales No. E.11.II.G.6.

Note: The data correspond to 2009 or the most recent year.
Abbreviations: LMI, lower middle-income; UMI, upper middle-income.

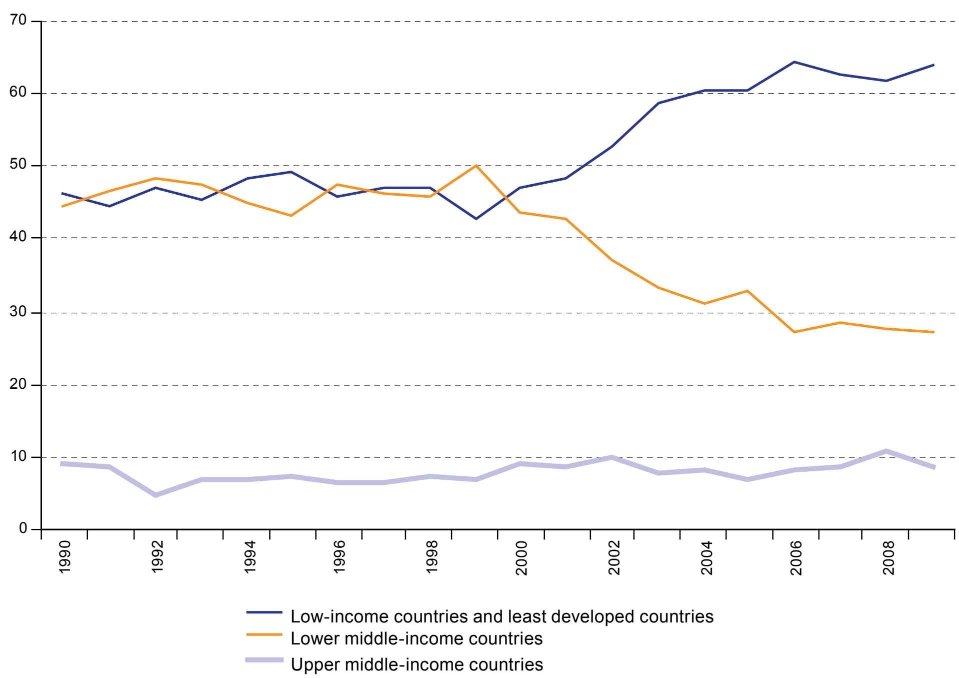
The cross-country differences among MICs are also significant in the area of structural features relating to productive and trade performance and to development potential. Pérez-Caldentey, Titelman and Vera (2011) present a number of indicators related to these issues, including measures of relative productivity, measures of how costly it is to start up a business in each country, indicators of export concentration and technological content of exports and indicators of the level of expenditure on research and development. In all cases, the common feature is the wide dispersion of outcomes among MICs, both at the global level and within the Latin American and Caribbean region.

However, the broad disparities that exist among countries classified as middle-income are seldom taken into account by donor countries and multilateral agencies when prioritizing the allocation of official development assistance (ODA). The rationale for ODA allocation in recent decades has been to channel the bulk of ODA towards low-income countries, including those classified as least developed countries (LDCs), to the detriment of MICs. The thinking is that since MICs have higher average incomes, their needs should be less.

2. Channelling of official development assistance towards low-income countries

The allocation of ODA has prioritized low-income countries to the detriment of MICs, and the trend has intensified since the 2000s. During the period 2000-2009, low-income countries and LDCs together received almost 60% of total ODA flows, while MICs received the remaining 40%. Within the MIC group, upper middle-income countries accounted for only one fifth of the flows (see figure 4).

Figure 4
SHARE OF TOTAL NET DISBURSEMENTS OF OFFICIAL DEVELOPMENT ASSISTANCE BY COUNTRY INCOME CATEGORY, 1990-2009
(Percentages)

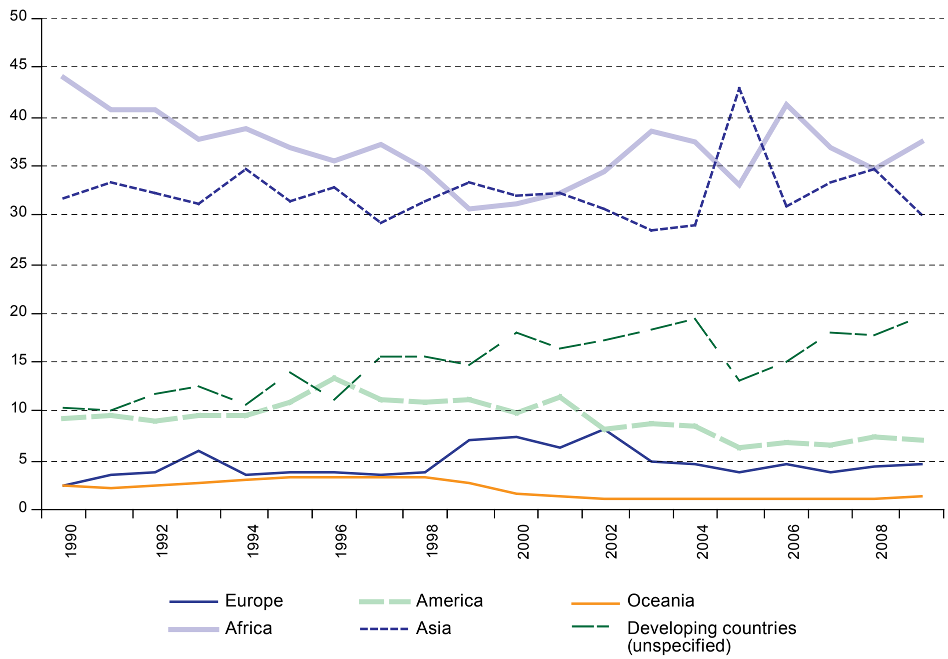


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Organization for Economic Cooperation and Development (OECD).

Note: Total official development assistance (ODA) was calculated as the sum of the three country income categories shown in the figure. Iraq was excluded from the lower middle-income group, in order not to distort the series. This country went from representing 1% of ODA disbursed to lower middle-income countries in 2002 to representing more than 50% in 2005.

The channelling of ODA towards low-income countries resulted in a concentration of assistance flows to the regions where many of these countries are located. Thus, Africa and Asia have historically received the largest proportions of ODA flows and currently enjoy the most substantial share (37% for Africa and 30% for Asia). By contrast, the relative share of ODA received by Latin America and the Caribbean fell from 9% in 1990 to 7% in 2009 (see figure 5). Of the US$ 127.5 billion in ODA channelled towards the developing countries in 2009, only US$ 9.1 billion went to countries in Latin America and the Caribbean.

Figure 5
SHARE OF TOTAL NET DISBURSEMENTS OF OFFICIAL DEVELOPMENT ASSISTANCE BY REGION, 1990-2009
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Organization for Economic Cooperation and Development (OECD).

This low —and falling— share of Latin America and the Caribbean in total ODA flows to the developing world is due precisely to the fact that most of the region's economies are classified as upper middle-income countries and receive very modest amounts of ODA. Moreover, not even the relatively low-income countries of the region are among the main recipients of ODA at the worldwide level; taking the average for the period 2000-2008, not a single country of Latin America and the Caribbean appears among the top 10 recipients of ODA as a percentage of GNI (United Nations, 2010).

Although it is to be expected that the international system of cooperation should focus on levelling the playing field for low-income economies and narrowing their development gap with respect to the more advanced countries, the discussion in the preceding sections points up that international cooperation mandates should not be limited to that focus. The fact that MICs have per capita incomes that are, on average, higher than in low-income countries does not mean that they are exempt from many of the challenges facing low-income countries. The international system of cooperation must address in earnest the diverse needs and vulnerabilities of MICs while keeping in view their pivotal importance in world economic and social affairs. In this regard, development assistance should preferably be allocated on the basis of a broader set of indicators (rather than using average income per capita as the main criterion) and those indicators should reflect the specific features of individual countries and reveal where the main areas of vulnerability and gaps lie in each case (United Nations, 2010; Pérez-Caldentey, Titelman and Vera, 2011).

3. Positive externalities derived from development cooperation with middle-income countries

Aside from the altruistic motivations discussed above for providing cooperation to MICs, there are also non-altruistic reasons for doing so because of the positive externalities that this could generate.

Given the importance of the MIC group in the world economy, these countries are of systemic importance in key areas that have the characteristics of global public goods, such as poverty reduction, global economic and financial stability, orderly flows of trade, protection of the environment, creation of knowledge, disease prevention and control of trans-border crime, including drug trafficking and money-laundering. Growth and stability in MICs therefore hold considerable potential to benefit the rest of the countries and underpin efforts to achieve global stability and peace (Fallon and others, 2001; Eyben and Lister, 2004).

With regard to poverty reduction, development assistance for MICs —which are home to 72% of the world's poor— would without a doubt have an important direct effect on reducing the number of poor. This direct effect would be complemented by an additional, indirect one, as growth in MICs could lead to increased investment in other countries (including low-income countries) and thus increased demand from those countries, with the consequent impact on poverty elsewhere (Eyben and Lister, 2004; Fallon and others, 2001).

As for global economic and financial stability, the role of MICs in providing such global public goods derives not only from these countries' large share in GDP, trade and other relevant variables nowadays but also from the high degree of global interconnectedness. Many of the financial crises of recent decades have demonstrated that the macroeconomic and financial policies of MICs are of importance not just to themselves but also to the entire system, given the scale of spillover and contagion among them.[3]

In terms of protection of the environment, sound pro-environmental policies in MICs are of key importance at a systemic level because many MICs have a significant impact on the state of the world's forests, biodiversity and greenhouse gas emission levels (Fallon and others, 2001). MICs, for example, account for 51% of the world's carbon dioxide emissions, so rapid MIC growth unaccompanied by such policies could have major repercussions in the form of environmental damage.

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3 Indeed, many of the financial crises of the 1990s had their origins in MICs in specific regions (South-East Asia and Latin America, for example) but then spread to countries in other regions.

Regarding the creation and transfer of knowledge, development cooperation with MICs can yield important positive externalities. First, the experience acquired through sound management of aid to MICs and the successful efforts to reduce poverty and inequality in these countries are an important source of lessons learned; low-income countries stand to benefit and learn from that development cooperation experience (Fallon and others, 2001). Second, many MICs are expanding their role in undertaking research and development (R&D) activities and should therefore be supported. Other MICs that are lagging behind in the R&D sector should receive support as well, as the benefits of R&D extend beyond the borders of those engaging in the actual R&D function and can provide a positive externality for the international community as a whole.

Finally, many international health threats (such as HIV/AIDS) and forms of cross-border crime (such as drug trafficking and money-laundering) count MICs among the providers of these global "public bads". Combating these scourges in MICs thus offers important positive externalities for the rest of the countries affected.

C. INNOVATIVE FINANCING MECHANISMS

The current level of financing provided through ODA to developing countries is clearly insufficient; and as a result, increases in assistance to some countries or regions sometimes occur at the expense of others (such as some MICs) that also have important needs.

Despite efforts by donor countries to increase the amount of ODA provided, levels are still far behind the internationally agreed target of 0.7% of GNI.[4] In addition, the massive fiscal and monetary rescue packages launched by most of the main developed economies to counter the effects of the global crisis resulted in a sharp deterioration in their public finances. This may impinge on the feasibility of increasing ODA flows substantially in the short run.

Against such a backdrop, the international community must urgently continue to explore innovative ways of mobilizing resources for development that supplement —not replace— ODA flows. Countries of both the northern and southern hemispheres have joined forces on different occasions to search together for ways to reduce the gap between large-scale needs and the lack of funding (Ffrench-Davis, 2007).

Pérez-Caldentey, Titelman and Vera (2011) reviewed a series of proposals on innovative finance for development (IFD) mechanisms that have been put forward, some of which have already been implemented and others not (see table 3 at the end of this section for a summary of some of those mechanisms). Following OECD (2011), they assigned innovative financing mechanisms to one of the following broad categories: (a) those that generate new public revenue streams (such as global taxes and special drawing right (SDR) allocations); (b) debt-based instruments and front-loading (such as debt swaps and international finance facilities); (c) public-private incentives, guarantees and insurance (such as advance market commitments (AMCs) and sovereign insurance pools); and (d) voluntary contributions using public or public-private channels (such as person-to-person giving). These categories are discussed in the paragraphs below.

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[4] Preliminary data indicate that in 2010 the level of ODA from the countries of the Development Assistance Committee (DAC) of the OECD averaged only 0.32% of their GNI (http://www.oecd.org).

1. Mechanisms generating new public revenue streams

The mechanisms that would generate new public revenue streams include global taxes, allocations of SDRs to developing countries and the auction or sale of emission permits.

In the area of global taxes, the idea of an international financial transactions tax (FTT) has been under discussion for many years and it has recently received renewed attention in the wake of the global financial crisis. The proposals differ: some advocate an FTT levied globally on all types of financial transaction (stock, bond, equity, spot and derivatives transactions, among others), while others suggest instead a tax on foreign exchange transactions (a currency transaction tax or Tobin tax). It is generally agreed that such taxes would raise substantial amounts of funding without causing serious distortions in the markets on which they are imposed. This is because the revenue base would be very broad and the rate should be very low (the range that has been proposed generally lies between 0.005% and 0.05%).

Estimates of the revenue-generating potential of a tax on all international financial transactions levied globally at a rate of 0.05% suggest it could yield US$ 661 billion annually (equivalent to 1.21% of world GDP). If applied only in Europe, it could raise US$ 289 billion annually; and if applied only in North America, US$ 278 billion annually (Schulmeister, 2010). A currency transaction tax of 0.005% on spot and derivative transactions in the four major trading currencies (dollar, euro, pound and yen) could raise US$ 33.4 billion annually (Schmidt, 2007).

A carbon tax —or tax on greenhouse gas emissions— would be intended, first, to raise funds for development and, second, to promote the regulation of emissions from all sources of fossil carbons. It has been estimated that a tax on carbon emissions of just US$ 0.05-US$ 0.35 per gallon could generate revenue on a level between US$130 billion and US$ 750 billion per year (Schmidt, 2007).

The solidarity levy on airline tickets is a tax on airline ticket sales that is coordinated internationally but implemented by individual countries. The levy has been applied since 2006 in Chile and France, which have since been followed by Côte d'Ivoire, Gabon and Mauritius. In 12 other countries, parliamentary meetings have been held to set up initiatives of this type and 19 countries have promised to introduce voluntary contributions. The amount of the tax varies according to the destination of the flight and the class of fare but it is supposed to be sufficiently low so as not to have damaging repercussions on air traffic, on the airlines or on passengers' choices. It is estimated that the solidarity levy on airline tickets has the potential to raise 400-500 million euros per year with the effective participation of more countries in the coming years.[5] In France alone, 544 million euros were raised between the tax's implementation in 2006 and 2009. The entirety of these funds went towards financing ODA in the health sector, specifically the International Drug Purchase Facility (UNITAID) and the International Finance Facility for Immunization (OECD, 2011).[6]

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5 See France Diplomatie [online] www.diplomatie.gouv.fr/en/france-priorities_1/development-and-humanitarian-action_2108/innovative-ways-to-fund-development_2109/.

6 The International Drug Purchase Facility (UNITAID) was established in 2006 to help combat the major pandemic diseases of HIV/AIDS, malaria and tuberculosis. It acts as a central buying organization and takes advantage of its buying power and financing formats to negotiate low prices for drugs and diagnostics and to promote the development and mass production of special drugs that do not yet exist or are not yet affordable (see [online] http://www.leadinggroup.org/rubrique177.html).

Several proposals have been made with respect to using special drawing right (SDR) allocations as a financial instrument to increase the resources available to developing countries for development purposes. It has been suggested, for example, that developed countries could transfer part of their SDRs to developing countries as additional concessional support or that more SDRs could be allocated to developing countries.

An alternative proposal was made by the investor George Soros at the United Nations Climate Change Conference, held in Copenhagen in December 2009. Mr. Soros proposed that, over a period of 25 years, the developed countries should set aside a portion (US$ 100 billion) of their last SDR allocation (made in September 2009) and use those amounts to create a fund for sustainable development.[7] This fund would be used for activities aimed at mitigation of and adaptation to climate change in developing countries (Soros, 2009). The calculations cited in the proposal indicated that with a US$ 100 billion fund, a total of US$ 7 billion in grants, loans and equity financing could be provided annually to the developing countries over the next 30 to 40 years.

2. Debt-based instruments and front-loading

Some common examples of debt-based instruments and front-loading are debt swaps, loan buy-downs and international finance facilities for the front-loading of future development assistance resources.

The Debt2Health swap, launched in 2007, is an innovative financing initiative of the Global Fund to Fight AIDS, Tuberculosis and Malaria.[8] It helps channel resources of developing countries with high debt and high disease burdens away from debt repayments towards investments in health. Under the initiative, the creditors of selected beneficiary countries agree to forgive portions of debt on the condition that the beneficiary governments invest an agreed portion in health programmes through the Global Fund.

Loan buy-downs are a combination of a loan (or credit) being granted to a developing country and a donor committing to buy down that loan (effectively transforming it into a grant) provided that predefined targets are achieved by the receiving country (World Bank, 2009). This means that the developing country receives the funds up front and it has an assurance that, upon successful achievement of predefined targets, a donor will pay off the debt.

An example of a financial instrument for the front-loading of resources is the international finance facility, proposed by the United Kingdom of Great Britain and Northern Ireland in 2003. The international finance facility was conceived as a mechanism whereby future streams (that is, future commitments) of development assistance from donor countries —over a 30-year time horizon— would be front-loaded to the present. This would be done by using long-term, legally binding pledges of development assistance from donors as assets to underpin the issuance of bonds in the international capital markets and in this way leverage the available resources for immediate development assistance.[9]

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[7] In September 2009, the International Monetary Fund (IMF) distributed to its members SDRs worth US$ 283 billion. Of this total, more than US$ 150 billion went to the 15 largest developed economies. According to Soros (2009), those SDRs will sit largely untouched in the reserve accounts of these countries, which have no real need for additional reserves.

[8] The Global Fund to Fight AIDS, Tuberculosis and Malaria is an international financing institution that supports large-scale prevention, treatment and care programmes against the three diseases (see [online] http://www.theglobalfund.org).

[9] The creditworthiness of donor countries and the binding nature of the commitments with respect to the flows of future assistance should make it possible to fund the international finance facility with very high quality bonds and, thus, at low cost.

The first instance of an international finance facility was the International Finance Facility for Immunization (IFFIm), established in 2004 by France and the United Kingdom, who were later joined by Australia, Italy, the Netherlands, Norway, South Africa, Spain and Sweden.[10] The IFFIm was launched as a pilot under the general principles of an international finance facility and would provide resources for the immunization sector by directing proceeds to the GAVI Alliance.[11] To date, the nine donor countries have pledged more than US$ 6.2 billion to the IFFIm over 23 years; and with these pledges IFFIm has managed to raise a total of US$ 3.4 billion through international bond issues since the first placement was completed in 2006.[12]

3. Public-private incentives, guarantees and insurance

Advance market commitments (AMCs) are an innovative mechanism designed to address the problem of pharmaceutical companies focusing their research on “rich country” diseases inasmuch as the demand in poor countries may be unpredictable and insolvent. The mechanism introduces a partnership between donors and pharmaceutical companies whereby the companies commit to conducting the necessary research and ensuring that once the medicines or vaccines are ready they are sold at an affordable price; donors ensure predictable and solvent demand once the research is completed (see [online] www.leadingroup.org).

Canada, Italy, Norway, the Russian Federation and the United Kingdom and the Bill and Melinda Gates Foundation have pledged US$ 1.5 billion and the GAVI Alliance has pledged US$ 1.3 billion through 2015 to an AMC pilot project for pneumococcal diseases. The project, launched in 2009, expects to have the new vaccine on the market in the next few years and manufacturers have committed to selling it at a low price for 10 years (see [online] www.leadinggroup.org).

The Caribbean Catastrophe Risk Insurance Facility (CCRIF), established in 2007, is an example of a sovereign insurance pool. Participating Caribbean countries are provided with affordable coverage for immediate budget support after a major natural disaster, such as an earthquake or hurricane (OECD, 2011). The CCRIF works as a form of parametric mutual insurance that is controlled by participating countries. Parametric insurance consists of an ex ante agreement to make payment upon the occurrence of a parametric trigger (such as a specified intensity of a natural disaster in a specific location as measured by an independent agency) and not against actual losses. This means that claims can be settled much faster than if the insurance were based on actual losses, which could take very long to quantify (see [online] www.CCRIF.org; Pérez-Caldentey, Titelman and Vera, 2011).

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[10] Recently (in June 2011), Brazil became the tenth donor, committing US$ 20 million to the IFFIm.

[11] The GAVI Alliance (formerly the Global Alliance for Vaccines and Immunization) was established in 2000 as a public-private partnership to boost immunization in the world’s poor countries. It brings together governments of various developed and developing countries, the World Health Organization (WHO), the United Nations Children’s Fund (UNICEF), the World Bank, the Bill and Melinda Gates Foundation, vaccine manufacturers, public health system institutions and non-governmental organizations (NGOs), among others.

[12] The IFFIm is classified as an AAA/Aaa/AAA issuer (see [online] http://www.iffim.org).

4. Voluntary contributions using public or public-private channels

An example of voluntary contributions is person-to-person (P2P) giving, an arrangement whereby individuals donate directly to individual recipients, normally through the Internet.

Another example is the RED initiative launched in 2006, which raises funds for the Global Fund to Fight AIDS, Tuberculosis and Malaria. This is a "blended value product", which refers to initiatives that stimulate voluntary contributions from individuals by combining charity with consumption. Partner corporations (which include Apple, Converse, Dell, Emporio Armani, GAP, Hallmark and Microsoft) design and sell specially branded RED products and make contributions with the corresponding percentage of the proceeds (World Bank, 2009).

A final example is Massivegood, a voluntary solidarity contribution pilot initiative launched in 2010 to raise funds for UNITAID. It is a mechanism through which travellers can contribute to development by making a US$ 2 contribution when they purchase travel services (airline tickets, hotel reservations, car rentals) through companies that are partners of the project (OECD, 2011; see [online] www.leadinggroup.org).

D. NEW CHALLENGES FOR MIDDLE-INCOME COUNTRIES IN THE WAKE OF THE GLOBAL CRISIS

The need for cooperation to be provided to MICs is further underscored by the new challenges that these countries are facing in the wake of the global crisis. In the particular case of Latin American and Caribbean MICs, the post-crisis scenario entails coping with new areas of vulnerability, such as large capital inflows (and their concurrent appreciation pressures), a narrowed fiscal space and high commodity (oil and food) prices.

Large-scale capital inflows constitute an initial area of vulnerability for the region's MICs in the post-crisis scenario. Interest rate differentials have coupled with favourable growth prospects to make many of these countries attractive to capital flows, which have started to inundate their economies: in 2010, net capital inflows to the region reached a record high of US$ 153 billion, double the level of 2009.[13] As a result, many countries have had to implement policies to cope with such inflows in the face of mounting appreciation pressures and rapid loss of competitiveness. Countries of the region have adopted measures ranging from intervention in the foreign exchange market (Chile) to the levying of taxes on certain flows (Brazil) in an effort to maintain a competitive exchange rate in order to sustain the current account.

Sound management of these large capital inflows is key not only from the standpoint of competitiveness but also for stability, as it can prevent the build-up of risks in the financial sector —such as those stemming from rapid credit growth and asset price bubbles— and it reduces vulnerability to sudden reversals in flows. Cooperation assistance for countries facing this challenge could help them to implement capital management policies that reduce vulnerability and prevent risk build-up in times of capital booms.

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[13] Of this total, less than half was in the form of foreign direct investment. The data are from the International Monetary Fund (IMF), World Economic Outlook Database, April 2011.

Table 3
SELECTED PROPOSALS ON INNOVATIVE FINANCING INSTRUMENTS FOR DEVELOPMENT

Mechanism	Main features	Development financing potential
	A. Mechanisms generating new public revenue streams	
Financial transactions tax (FTT) or currency transaction tax	Some proposals advocate an FTT levied globally on all types of financial transaction; others suggest instead a tax on foreign exchange transactions. It is generally agreed that such taxes would raise substantial amounts of funding without causing serious distortions in the markets because the revenue base would be very broad and the rate very low (the range proposed is between 0.005% and 0.05%).	An FTT on all international financial transactions levied globally at a rate of 0.05% could raise US$ 661 billion annually (equivalent to 1.21% of world GDP). A currency transaction tax of 0.005% on spot and derivative transactions in the four major trading currencies (dollar, euro, pound and yen) could raise US$ 33.4 billion annually.
Carbon tax	This tax would have the dual objective of raising funds for development and promoting the regulation of emissions from all sources of fossil carbons.	A tax on carbon emissions of US$ 0.05-US$ 0.35 per gallon could generate estimated revenue of between US$ 130 billion and US$ 750 billion per year.
Tax on airline ticket sales	The levy has been applied since 2006 in Chile and France, which have since been followed by Côte d'Ivoire, Gabon and Mauritius. In 12 other countries, parliamentary meetings have been held to set up initiatives of this type and 19 countries have promised to introduce voluntary contributions.	It is estimated that the solidarity levy on airline tickets has the potential to raise 400-500 million euros per year with the effective participation of more countries in the coming years. In France alone, 544 million euros were raised between the tax's implementation in 2006 and 2009.
Special drawing right (SDR) allocations for development	One example is the proposal by investor George Soros to assign SDRs of the developed countries to set up a fund for sustainable development that would be used to finance plans for climate change mitigation and adaptation in the developing countries.	Estimates cited in the Soros proposal indicate that a fund of US$ 100 billion equivalent in SDRs (loaned by the developed countries over 25 years) could provide US$ 7 billion per year in grants, loans and equity capital to the developing countries over the next 30-40 years.
Arms trade tax	This proposed global tax would have the dual aim of reducing trade in arms and raising money for development purposes. Among the objections raised are that such a tax might create incentives for illicit trade in arms and the probability that developing countries —as the purchasers rather than sellers of arms— would end up paying the larger part of the tax (World Bank, 2009).	
Auction or sale of emission permits	Where a cap-and-trade mechanism exists for emissions (for example, within the European Union Emissions Trading Scheme), emission allowances may be auctioned or sold instead of being allocated at no charge to emitters and the proceeds could be directed to financing international development.	In 2008, Germany auctioned European Union allowances totalling nearly 1 billion euros, of which 120 million euros was earmarked for investment in international climate protection measures in developing countries (World Bank, 2009).
	B. Debt-based instruments and front-loading	
Debt swaps	*Debt-for-health swaps.* Under this initiative (launched in 2007), the creditors of selected beneficiary countries agree to forgive portions of debt on the condition that the beneficiary governments invest an agreed portion in health programmes linked to combating HIV/AIDS, tuberculosis and malaria through the Global Fund. *Debt-for-nature swaps.* A similar idea is behind this arrangement, which was first conceived in the early 1980s and whereby a portion of a country's foreign debt is forgiven in exchange for local investments in environmental policies or local conservation measures.	
Loan buy-downs	This arrangement involves a combination of a loan (or credit) being granted to a developing country and a donor committing to buy down that loan provided that predefined targets are achieved by the receiving country.	

Table 3 (concluded)

Mechanism	Main features	Development financing potential
International Finance Facility for Immunization (IIFIm)	An example of a financial instrument for the front-loading of resources is the IFFIm, established in 2004 by France and the United Kingdom, who were later joined by Australia, Italy, the Netherlands, Norway, South Africa, Spain and Sweden. Under this mechanism, long-term legally binding pledges of development assistance from donors are used as assets to underpin the issuance of bonds in the international capital markets and thus leverage the available resources for immediate development assistance.	To date, the nine donor countries have pledged more than US$ 6.2 billion to the IFFIm over 23 years. With these pledges, the IFFIm has managed to raise a total of US$ 3.4 billion through international bond issues since 2006.
C. Public-private incentives, guarantees and insurance		
Advance market commitments (AMCs)	This mechanism seeks to address the problem of pharmaceutical companies focusing their research on “rich country” diseases, as demand from poor countries may be unpredictable and insolvent. The mechanism introduces a partnership between donors and pharmaceutical companies whereby donors ensure predictable and solvent demand once research is completed and the pharmaceutical companies commit to conducting the necessary research and ensuring that once the medicines or vaccines are ready, they are sold at affordable prices.	Canada, Italy, Norway, the Russian Federation and the United Kingdom and the Bill and Melinda Gates Foundation have pledged US$ 1.5 billion and the GAVI Alliance has promised to allocate US$ 1.3 billion through 2015 to an AMC pilot project for pneumococcal diseases. The project, launched in 2009, expects to have the new vaccine on the market in the next few years and manufacturers have committed to selling it at a low price for 10 years.
Sovereign insurance pool	The Caribbean Catastrophe Risk Insurance Facility (CCRIF) is a sovereign insurance pool that was established by Caribbean countries in 2007 to provide affordable coverage for immediate budget support after major natural disasters. The CCRIF works as a form of parametric mutual insurance, meaning there is an ex ante agreement to make payment upon occurrence of a parametric trigger (such as a specified intensity of a natural disaster in a specific location as measured by an independent agency) rather than against actual losses. In this way, claims can be settled much faster than under insurance based on actual losses, which could take very long to quantify.	
D. Voluntary contributions using public or public-private channels		
Person-to-person (P2P) giving	Under this arrangement, individuals donate directly to individual recipients, normally through the Internet. For example there are online platforms that channel direct microfinance investments to entrepreneurs in developing countries.	
Blended value products	The RED initiative launched in 2006 is an example of a “blended value product”, which refers to initiatives that stimulate voluntary contributions from individuals by combining charity with consumption. Partner corporations (including Apple, Converse, Dell, Emporio Armani, GAP, Hallmark and Microsoft) design and sell specially branded RED products and make contributions with the corresponding percentage of the proceeds (World Bank, 2009).	
Voluntary solidarity contributions	Massivegood is a pilot initiative that was launched in 2010 and allows travellers to contribute to development by making a US$ 2 contribution when purchasing travel services (airline tickets, hotel reservations, car rentals) through companies that are partners of the project.	

Source: Esteban Pérez-Caldentey, Daniel Titelman and Cecilia Vera, “Middle-income countries and the system of international cooperation: the way forward”, unpublished, 2011.

A second area of vulnerability in the post-crisis scenario is the smaller fiscal space. Many MICs in the Latin American and Caribbean region implemented fiscal stimulus policies in 2009 to counteract the economic and social impacts of the crisis and this led to a deterioration of their fiscal situation. That, in turn, reduced the fiscal space now available to countries for implementing development policies. Although some of the region's MICs will benefit from rising revenue and activity levels (with concurrently lower debt-to-GDP ratios), others will face greater fiscal challenges than before.[14] In this sense, for the many MICs that may now face constraints on public spending, ODA flows should play the role of compensating for shortages of resources and thereby prevent possible setbacks in social achievements, including advancement towards the Millennium Development Goals. Donor countries and multilateral institutions should bear in mind that the deterioration of social indicators is not just a problem for those who have unmet needs at present: it can also have much longer-term consequences and cause lasting damage that could spill over into subsequent generations (United Nations, 2010).[15]

Finally, another area of vulnerability in the current scenario (outside the fiscal area) can be found in rising commodity prices, including food and oil prices. The events in North Africa and the Middle East —and the related concerns about future supply— have combined with a weaker dollar to push oil prices to a high not seen since August 2008. Despite the slight downtick in May and June 2011, oil prices are still 140% higher than at the beginning of 2009. Food prices are up by 42% compared with the same date (see figure 6).[16]

This upward trend implies a benefit for countries that produce and export commodities but a disadvantage for countries that are importers and consumers of commodities. For the Central American subregion (where countries are generally importers of oil), the rise in the oil bill, for instance, will mean revenue losses in the billions of dollars.[17]

Higher food prices in turn affect the levels of extreme poverty in countries that are not producers of food commodities. For example, ECLAC has calculated that a rise of 15% in food prices could increase the rate of extreme poverty by between 2 and 2.9 percentage points on average in Latin America and the Caribbean (ECLAC, 2008).

It is thus evident that MICs —especially those in the Latin American and Caribbean region— remain highly vulnerable to the vagaries of macroeconomic events. The post-crisis scenario poses new challenges for many MICs that will have to deal with new areas of vulnerability in addition to the traditional ones.

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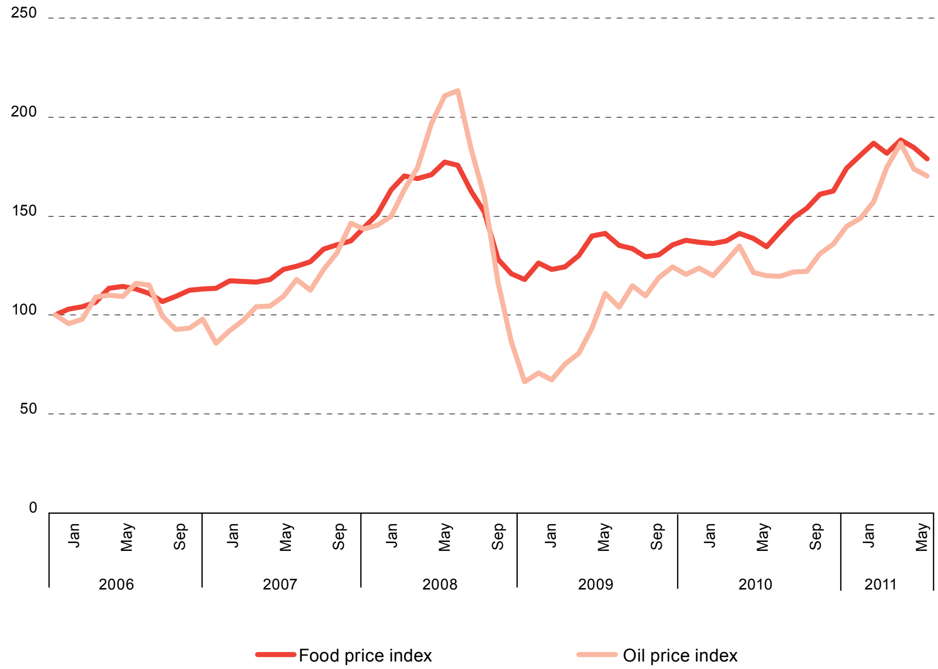
[14] Resorting to public indebtedness to finance development is not a healthy option for some countries, such as some Caribbean countries where public debt-to-GDP ratios are above 100%.

[15] For example, deficiencies in nutrition, health and education can result in a deterioration in human capital with long-term repercussions for the development capacity of countries, including long after specific indicators have started to pick up.

[16] These calculations refer to the crude oil price index and the commodity food prices index prepared by IMF; the comparison is June 2011 versus January 2009.

[17] See, for example, the calculations in Machinea (2006).

Figure 6
OIL AND FOOD PRICES, JANUARY 2006-MAY 2011
(*Index: January 2006=100*)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the International Monetary Fund (IMF).

Note: The oil price index is the simple average of UK Brent, Dubai and West Texas Intermediate.

E. THE WAY FORWARD

As noted earlier, the fact that MICs have per capita incomes that are, on average, higher than those of low-income countries does not mean that they are exempt from many of the challenges facing low-income countries. The diversity of situations found in the middle-income category implies that many of these countries present areas of significant vulnerability related not only to their economic and social situation but also to structural features linked to productive performance and development potential. Moreover, as a consequence of the global crisis, many MICs —including some in Latin America and the Caribbean— may have become even more vulnerable.

Accordingly, it bears repeating here that the system of international cooperation should search for a comprehensive and broad-based response to the development problem, one that not only addresses the needs of low-income countries but also considers the diverse needs and kinds of vulnerability present in MICs.

For this, it is vital to have a comprehensive understanding of where the major needs and areas of vulnerability lie in each case and where the main gaps are between needs and possibilities so that development assistance may be allocated appropriately.

A crucial step forward in this direction will be the revision of the criteria used for country classification and the substitution of the currently used income-based criteria with new, better-suited indicators. These new indicators should be able to capture the multifaceted nature of development and thus lead to country groupings that are less heterogeneous internally.

More specifically, these indicators should reflect structural challenges and areas of vulnerability that are present in MICs but not captured by income per capita thresholds. In the case of Latin American and Caribbean MICs, these traditional long-term challenges and areas of vulnerability can be summarized in what ECLAC identified as key gaps that must be closed in order to avert the “middle-income trap” and move to a sustainable and dynamic development process that places equity at its centre (ECLAC, 2010a). Those gaps include the financing gap, the inequality and social protection gap, the human capital gap and the productivity and investment gap (for an in-depth discussion of development gaps, see ECLAC, 2010a).

Besides developing better criteria for ODA allocation, the international community must persist in the effort to increase the resources available for development financing. The current level of ODA financing provided to developing countries is clearly insufficient; and as a result, increases in assistance to some countries or regions sometimes occur at the expense of others (such as some MICs) that also have important needs.

Despite efforts by DAC donor countries to increase the amount of ODA provided, the levels in 2010 stood at only 0.32% of GNI on average, far behind the internationally agreed target of 0.7% of GNI. In addition, the public finances of many donors deteriorated substantially in the wake of the global crisis, making the scaling up of development assistance levels less likely. At the same time, the post-crisis scenario has added new areas of vulnerability to the traditional ones faced by some developing countries, and therefore the tension will persist between scarce resources and vast needs.

It is therefore of vital importance that the international community pool efforts to come up with innovative ways of mobilizing resources for development that supplement —not replace— ODA flows. Countries of both the northern and southern hemispheres have joined forces on different occasions to develop innovative finance for development mechanisms. The proposals range from specific types of global taxes to mechanisms that facilitate private, person-to-person voluntary donations. Some of these proposals are already being implemented and the results are encouraging. Nevertheless, much remains to be done in this area and the international community should invest seriously in efforts to that end.

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