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Globalization and interdependence: development cooperation with middle-income countries

Development cooperation with middle-income countries

Report of the Secretary-General

Summary

Middle-income countries have made remarkable economic and social progress on a broad front over recent decades. Progress has been uneven and diverse, however, and formidable challenges remain. Despite substantial progress in reducing poverty, middle-income countries remain home to about 75 per cent of the world's poor, who live on less than $1.25 per day. Income inequality tends to be higher among middle-income countries than low- or high-income countries. Achieving more sustained and inclusive growth remains challenging for countries that have not managed to diversify their economies and shield them against volatile market conditions.

The United Nations system and the multilateral financial institutions have been important partners and facilitators for international development cooperation with middle-income countries. While recognizing that no one size fits all, there is a strongly felt need to develop better international cooperation to support middle-income countries in addressing their development challenges, in particular the support provided by the United Nations system.

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I. Introduction

1. At its sixty-fourth session, in 2009, the General Assembly recognized that middle-income countries still faced significant challenges in their efforts to achieve the internationally agreed development goals. It underlined the importance of various forms of international support that were well aligned with national priorities so as to address their development needs, and acknowledged the efforts made and successes achieved by many middle-income countries in eradicating poverty and achieving the development goals, as well as their contribution to global and regional development and economic stability.

2. In resolution 64/208, the General Assembly requested the Secretary-General to submit a report on development cooperation with middle-income countries, with a focus on the existing strategies and actions of the United Nations system on development cooperation with middle-income countries, taking into account the work of other relevant international organizations, including international financial institutions. The present report responds to that request.

3. The resolution does not provide a precise definition of the category of middle-income countries. Like the previous report on this matter (see A/64/253), the present report tentatively identifies middle-income countries as those with a per capita gross national income (GNI) of between $996 and $12,195, following the World Bank classification.[1] In 2011, 104 countries are in this category, of which 56 are categorized by the World Bank as lower middle-income countries, with a per capita GNI of less than $3,945. The World Bank does not recognize the United Nations category of least developed countries, but instead identifies low-income countries as a specific category in terms of its lending policies. In this sense, middle-income countries have emerged between the low- and high-income categories as an intermediate category defined in terms of per capita income alone, unlike the category of least developed countries, which also considers economic and environmental vulnerability and the level of human development.[2] In the United Nations system the category of middle-income countries is therefore often used to refer to developing and transition economies not categorized as least developed countries.

4. As a group, middle income countries account for more than 70 per cent of the world population and almost 43 per cent of world gross product, measured in purchasing power parity terms. With a number of economies in this group sustaining rapid growth over the past decade, the contribution of middle income countries to global growth has increased, thereby reshaping patterns of global production, trade, capital flows and technology and labour conditions. The growth of these economies has also produced positive spillovers for other developing countries, through increased trade linkages, capital flows and South-South development cooperation. Notable reductions in extreme poverty have occurred in middle-income countries in recent years. Although the group of middle-income countries continues to expand,

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[1] Income classifications of the World Bank are set each year on 1 July. The present report refers to middle-income countries categorized as such during the period from 1 July 2010 to 30 June 2011.

[2] For least developed country criteria, see *Handbook on the Least Developed Country Category: Inclusion, Graduation and Special Support Measures* (United Nations publication, Sales No. E.07.II.A.9).

these countries are still home to three quarters of the world population who live on less than $1.25 per day.

5. Economic progress among middle income countries has been highly varied, with some witnessing strong and sustained growth in recent decades, and others seeing less progress and more volatility, especially the less diversified economies that rely heavily on primary commodity exports. Progress towards achieving the Millennium Development Goals has been similarly uneven.

6. The present report discusses some of the major economic and social development challenges facing middle-income countries, cooperation of the United Nations system with middle-income countries and implications for further engagement of the system with these countries.

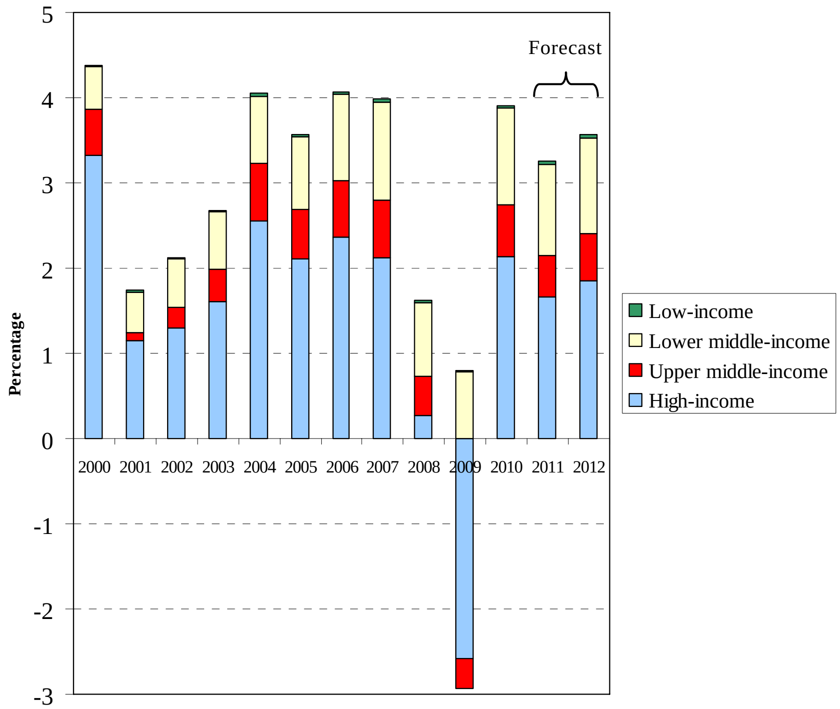
II. Major challenges for the development of middle-income countries

A. Recent macroeconomic trends[3]

7. In the aftermath of the global financial crisis, many middle-income countries have fared better than developed economies. Economic growth in middle-income countries has been almost twice the world average. Middle-income countries have contributed to about half of the post-crisis recovery of the world economy (see figure). The outlook, however, indicates that growth in many of these economies is moderating owing to various constraints, including continued weaknesses in developed economies, in addition to surging and volatile capital flows and global commodity prices, which are posing macroeconomic policy challenges. In particular, inflationary pressures, pushed by higher global commodity prices, are mounting and are often exacerbated, in many instances, by rapid credit growth and supply shortages in agriculture. Higher food and energy prices have eroded real incomes, in particular those of the poor. Tackling them is especially important for middle-income countries, as they are home to the vast majority of the global poor.

[3] Information in the present chapter is drawn from *World Economic Situation and Prospects 2011* (United Nations publication, Sales No. E.11.II.C.2), and *World Economic Situation and Prospects: Update as of mid-2011*.

Figure
Contribution to world economic growth by groups of countries by income level, 2000-2012



Source: Department of Economic and Social Affairs, database of *World Economic Situation and Prospects*, May 2011.

8. By region, middle-income economies in East Asia and South Asia continue to experience the strongest growth. Growth in these regions was driven mainly by the rebound in investment and in export manufacturing, supported by fiscal and monetary policy stimuli. Strong private consumption growth in the larger economies, such as China, India and Indonesia, has created positive spillover effects for neighbouring economies and has catalysed employment growth. Indeed, employment levels have risen to above pre-crisis levels. While having diversified their economies, the smaller economies in these regions still rely mainly on exports to developed regions and are also vulnerable to swings in capital flows.

9. The recovery in international trade and the rebound of the economies in East Asia and South Asia have contributed to recent surges in commodity prices. This has had a positive impact on economic activity in other regions, in particular in resource-rich countries in West Asia, Latin America, Africa and the Commonwealth of Independent States. As noted above, however, the recovery is also creating considerable macroeconomic challenges. Thus, growth in many of these economies is likely to remain more volatile than in those of East Asia and South Asia. Additionally, improved growth performance in recent years has not gone hand-in-hand with diversification of their underlying economies. Consequently, broad segments of their populations are unable to find decent jobs. In some middle-income countries, especially in West Asia and North Africa, employment opportunities for

young workers are particularly scarce and were a factor in the recent political uprisings.

10. Recovery in middle-income countries in Eastern Europe has strengthened since late 2010, but remains predominantly export-led, while domestic demand has yet to rebound. In South-Eastern Europe, strong export growth, supported by higher commodity prices and increased tourism demand, and a modest recovery in remittances pulled the region out of recession in 2010, but recovery remains feeble.

B. Poverty and inequality in middle-income countries

11. Although the recent global economic crisis has increased poverty in many countries, significant progress has been made in reducing poverty in middle-income countries over the past two decades. About 600 million people living in what are now middle-income countries managed to emerge from extreme poverty — that is, living on incomes of under $1.25 per day valued at purchasing power parity rates for 2005 — since the beginning of the 1990s, compared with less than 3 million in countries currently classified as low-income (see table).[4] Poverty reduction in middle-income countries has been less substantial when measured against a poverty line of $2 per day, still leaving almost 2 billion people in moderate poverty. This suggests the vulnerability of a large number of the “near poor” to shocks.

12. Poverty reduction has been most significant in middle-income countries in South Asia, East Asia and parts of Latin America and the Caribbean, notably in Brazil, China, Indonesia, Pakistan and Viet Nam. In contrast, the number of people living in extreme poverty in the 18 middle-income countries of sub-Saharan Africa has increased by more than 32 million since the beginning of the 1990s.[5]

[4] The comparison is made on the basis of a sample of 88 countries classified as middle-income countries in 2009, including China and India, which up until fairly recently were still classified as low-income countries.

[5] While poverty rates are falling in Africa, high population growth is contributing to rising numbers of those living in extreme poverty.

Table
Number of poor by country income level, 1990-1994 and 2005-2009 (millions)

	Earliest data for the period 1990-1994	*Latest data for the period 2005-2009*	*Change*	*Percentage share of world's poor 2005-2009*
Number of extreme poor (living on less than $1.25 per day)				
Low-income countries	323.5	320.8	-2.6	25
Lower middle-income	1 502.1	923.5	-578.7	72
Upper middle-income	56.1	36.7	-19.4	3
High-income countries	1.7	0.0	-1.6	0
Total	**1 883.4**	**1 281.1**	**-602.3**	**100**
Number of poor (living on less than $2.00 per day)				
Low-income countries	432.8	494.8	62.0	20
Lower middle-income	2 236.8	1 844.0	-392.7	76
Upper middle-income	131.9	92.1	-39.8	4
High-income countries	3.5	0.1	-3.4	0
Total	**2 805.0**	**2 431.1**	**-373.9**	**100**

Source: Department of Economic and Social Affairs, based on data drawn from the official United Nations Millennium Development Goals indicators website (available from http://mdgs.un.org/unsd/mdg/data.aspx).

13. Sustained robust growth has been an important factor in driving down poverty rates, but poverty reduction has been much more significant where growth has been driven by dynamic structural economic change, building on productivity improvements in agriculture and diversifying into job-intensive industrial activities and continuous investments in education. These have been key elements of successful poverty reduction in East Asia and parts of South Asia. Countries with less diversified economies that rely on income from natural resource extraction have been more likely to have experienced less resilient and less inclusive growth with higher income inequality.

14. The distribution of income tends to be far more unequal in middle-income countries than in low- or high-income countries. However, also in this regard, conditions vary greatly among middle-income countries. Both the highest and the lowest degree of country income inequality in the world — Namibia and Belarus, respectively — are found within that group.[6] By region, Latin America continues to have the highest degree of income inequality on average, although marked improvements have been made since 2000. The concentration of income tends to be lower in South Asia and Central Asia. Starting from relatively low levels, middle-income countries in Eastern Europe and Central Asia saw the sharpest increases in

[6] Namibia registered a Gini coefficient of 0.68 in 2005, while the measure for Belarus in 2007 was 0.27. The Gini coefficient is a widely used measure of inequality ranging between 0 and 1; the higher the coefficient, the greater the income inequality.

inequality between 1990 and 2008.[7] Rising income inequality is sometimes the outcome of dynamic growth processes, for instance as workers shift from lower-productivity activities, such as agriculture, to higher ones, such as manufacturing. Nevertheless, persistently high income gaps tend to diminish the poverty-reducing effect of growth and shrink economic growth itself over time. Rising inequality is also a source of social unrest, which could hinder efforts to reach the internationally agreed development goals.

15. A number of factors have varying degrees of impact on the dynamics of inequality. Social factors — such as discrimination, social exclusion and informal and formal practices — often foster inequality, while the economic drivers of higher inequality include credit market imperfections, unequal access to natural resource income, unfair globalization, labour-displacing technological change and capital-intensive or skill-intensive industrialization. For instance, in countries where natural resources are relatively abundant, shares in total national income of income from land and natural resources are often high and unequally distributed. This may, in part, explain why income inequality in resource-rich countries and regions, such as sub-Saharan Africa and Latin America, is higher than in less resource-rich countries and regions, such as South or East Asia. Similarly, globalization and technological change may contribute to higher levels of inequality, as advanced industrial technology tends to favour the relative demand for skilled labour, which leads to greater income differentials within a country, at least in the short run. In comparison with a few decades ago, today's higher income inequality in some countries is partly explained by the virtual abandonment of most earlier efforts to redress spatial and other inequalities, in addition to the inegalitarian consequences of many processes associated with market liberalization and the strengthening of private property rights at national and international levels alike.

16. Inequality influences poverty through multiple channels. For example, inequality can hinder growth, which in turn affects poverty. Moreover, where inequality is high, growth is less effective in reducing poverty, as inequality decreases the extent to which the poor benefit from overall growth. There is also growing evidence that high levels of inequality, particularly in terms of opportunities and among regions or ethnic groups, may fuel violent conflict and jeopardize social stability, thereby undermining development and poverty reduction, as was recently experienced in parts of North Africa and the Middle East.

17. Inequality also tends to affect progress in meeting human development goals in education and health. For instance, in the Arab States, East Asia and the Pacific and Latin America and the Caribbean, the risk of early childhood death is about twice as high among households in the bottom quintile of income distribution than among those in the top quintile. In Indonesia and Nicaragua, infant deaths in the poorest quintile are even more than three times as common as in the richest. In the Plurinational State of Bolivia and Peru, mothers and children from the richest quintile have almost universal access to a skilled attendant at birth, while only 10 to 15 per cent of the poorest do. Similarly, children from the poorest households, especially those living in rural areas, are less likely to be enrolled in school. Girls in the poorest quintile of households are three and a half times more likely to be out of school than girls in the richest households, and four times more likely than boys in

[7] See Isabel Ortiz and Matthew Cummins, "Global inequality: beyond the bottom billion", United Nations Children's Fund, Social and Economic Policy Working Paper (New York, April 2011).

the richest households. Such inequalities tend to be perpetuated in access to employment and income opportunities.

C. Policy challenges

18. The diversity of middle-income countries also implies that their policy challenges are different. For most, however, short-term macroeconomic challenges include dealing with the impacts of rising inflation and surging capital inflows. Many Governments have responded by tightening monetary policy, including by raising interest rates and increasing bank reserve requirement ratios. As real interest rates in some of these economies remain low, monetary tightening is likely to continue for the rest of 2011. As a number of Governments have also started to unwind fiscal stimulus measures, combating inflation by monetary tightening may come at the expense of some growth and employment, but is also unlikely to be effective when inflation is caused mainly by surging food and energy prices.

19. A number of middle-income countries have also adopted capital flow control measures to mitigate the risks of capital flow volatility, which can have a destabilizing effect. At present, high capital inflows have exerted upward pressure on exchange rates and worsened asset price bubbles, which in turn are undermining export competitiveness and, in some cases, economic diversification efforts. While the conventional policy reaction to inflation would be to set higher policy interest rates, this would only exacerbate the problem by attracting even more capital inflows. Although capital controls have been moderate, they have led to a shift from short-term to longer-term investments instead of an outright drop in capital inflows.

20. In the medium and long run, the challenge for Governments of middle-income countries is to ensure that macroeconomic policies are, or remain, supportive of balanced, equitable and inclusive growth. While the related policy framework must be tailored to the prevailing conditions and needs of country-specific contexts, some general policy directions may be suggested.[8]

21. Many middle-income countries are still building their productive capacities. Markets in many middle-income countries are not always fully developed, especially in commodity-exporting countries. Although exports of primary commodities have contributed to high growth in some countries, inequality has increased as income gains have not been evenly distributed. Particularly in these economies, the key challenge is to adopt effective national development strategies aimed at diversifying the economy and reducing dependence on primary exports. In many countries, this means prudential and economic regulation of the financial sector, increased investment in infrastructure and agricultural development and the creation of favourable conditions for industries with potential economies of scale to foster remunerative employment creation in the formal sector. Indeed, as witnessed, the fast-growing East Asian economies achieved dynamic structural change by embedding macroeconomic policies in broader national development strategies that did not substitute industrial policy with generalized trade liberalization. Such changes require substantial efforts to build national capacities so as to ensure a more active and developmental role for Government.

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[8] See, for example, chapter II in *World Economic and Social Survey 2010: Retooling Global Development* (United Nations publication, Sales. No. E.10.II.C.1).

22. Experience has shown that macroeconomic policies tend to be more supportive of development when they are consistently countercyclical, such as the accumulation of fiscal buffers in good times which can be used in bad times. This could entail establishing commodity stabilization funds, as was the case in Chile, for instance. Such rules would also extend the regulatory frameworks for the domestic financial sector and management of international capital flows, for example in Chile and Malaysia. Monetary policies would need to be coordinated with financial sector and industrial policies. In East Asia, for example, Governments have directed and subsidized credit schemes and managed interest rates so as to directly influence investment, initially in labour-intensive industries, as expansion of employment is essential to reducing poverty, and then in industries with the greatest potential for upgrading skills, enabling them to reap economies of scale and raise productivity. Policies should also mirror agricultural development to ensure food security.

23. Particularly in middle-income countries, where inequality is high and the benefits of growth are not shared evenly, Governments should consider complementing the macroeconomic framework with comprehensive social policies, such as public provision of primary health care and basic education, employment guarantee schemes and cash transfers to ensure that income and opportunity gaps do not persist or increase over time. Greater revenue collection and redesigned redistributive policies are tools with which Governments can tackle inequality and resolve issues of indebtedness and persistent deficits. A broader tax base would serve, inter alia, to strengthen social protection systems and make social services more universally accessible. In many middle-income countries, welfare transfer programmes, such as conditional cash transfers, are being used to provide greater income protection to the poor and to enhance their access to education and health services. By reducing inequality of access to education and health, such programmes can foster long-term economic growth. Brazil's *Bolsa Familia* programme, for instance, covers the largest number of recipients among developing countries (currently, about 12 million Brazilian families) and has contributed to achieving notable progress in other areas related to the Millennium Development Goals, such as reducing malnutrition and child mortality and achieving universal education. The results of these programmes may vary, however, depending on individual circumstances. For instance, in urban areas where the incidence of poverty is high, such cash payments alleviate poverty but may not significantly increase human resource development if enrolment rates are already high. Moreover, greater spending on education will not raise future income if broader macroeconomic policies fail to generate sufficient productive employment opportunities.

24. Redistributive transfers among regions can also help to reduce inequality and combat poverty. Inequalities between commodity-rich and commodity-poor regions can be addressed by sharing commodity-based revenues. Rules for the sharing of revenues from mineral production between central and local Governments have been adopted, for instance, in the Bolivarian Republic of Venezuela, Colombia, Indonesia, Kazakhstan and Mexico.

25. To address the inequalities caused by globalization and the differences between returns to skilled and unskilled labour, greater priority may need to be placed on education and technology policies to expand the supply of skilled labour and disseminate new technologies among the population. In some contexts, Governments may further wish to consider gradually phasing out the preferential treatment for foreign companies that many had introduced in earlier stages of

development to attract foreign direct investment. In China, for example, a unified tax rate for foreign and domestic companies has been applied since 2008 to foster the growth of domestic industries. This creates a more level playing field for domestic businesses that compete with foreign subsidiaries and could stimulate demand for skilled labour. In addition, it stops an important source of revenue loss and hence enhances fiscal space.

26. Other policies to address inequality could include increasing labour force participation rates, in particular for women and older workers, and upgrading low-skill, low-wage and vulnerable employment. Vulnerable employment can also be addressed by adopting or raising minimum wage requirements, providing greater employment protection or investing in training and upgrading the skills of vulnerable workers. Public works programmes have also been successfully used to reduce poverty. For instance, the National Rural Employment Guarantee Act in India provides 100 days of paid work every year to each rural household needing employment and pays the statutory minimum wage. In India's fiscal year 2009/10, almost 55 million households were provided with employment under the Act, with over 48 per cent participation by women. A further option may be to encourage foreign firms to employ local workers and to invest in local development. For instance, in 2010, Anglo American, one of the world's largest mining groups, unveiled an enterprise development venture to strengthen local economies in South Africa in 2010.

27. A broader macroeconomic policy framework should also embrace more explicit efforts to expand and deepen financial markets and increase financial inclusion. Commercial banks usually prefer large borrowers and are often reluctant to provide loans to small and medium-sized enterprises, which are the main providers of employment in many middle-income countries. New companies have difficulties accessing credit, which limits their expansion, while many households in the informal sector or in rural areas are also constrained owing to poor access to banking and insurance services. While the extension of microfinance would bean important step in this direction, to date such institutions account for less than 1 per cent of the credit provided by commercial banks in Latin America. Public policies should aim instead to broaden financial inclusion by adopting such measures as specialized financial institutions for small and medium-sized enterprises and for farmers. They should also focus on supporting the capitalization of lending institutions and on reforming the regulatory framework for capital and collateral requirements. Fiscal incentives that encourage group lending and more timely bankruptcy procedures would increase the supply of conventional bank credit in particular, and banking services in general, to the poor, thereby broadening financial inclusion.[9]

28. Having achieved higher levels of per capita income, it is particularly important that middle-income countries intensify efforts to make their development more sustainable. Sustained growth is not the same as sustainable growth. Current rates of urbanization and technologies use are rapidly depleting and polluting the natural resources that support life on the planet.[10] An important component of sustainable

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[9] See *Annual Report to the Secretary-General, 2010*, Special Advocate of the Secretary-General for Inclusive Finance for Development.

[10] See *World Economic and Social Survey 2011: The Great Green Technological Transformation* (United Nations publication, Sales No. E.11.II.C.1).

development in middle-income countries will be to adopt and spread green technologies and sustainable national resource management strategies. For instance, minimizing land degradation, rehabilitating degraded areas and optimizing land use are crucial for sustainable land management. At the same time, achieving food security that is also sustainable would require the use of more environmentally friendly farming techniques. While agricultural technologies and practices need to be adapted to local conditions, an extensive menu of technologies and sustainable practices in agriculture is available and provides options for a radical shift towards sustainable food security, including traditional knowledge and farming practices, such as low-tillage farming, crop rotation, interplanting, green manure utilization, water harvesting and water-efficient cropping. Such practices offer vast win-win opportunities to increase farmers' productivity and income, reduce malnutrition and restore fragile environments, and help to mitigate climate change. Delinking economic growth and environmental degradation would further require a transformation of energy systems through investments in energy efficiency and the diffusion of clean energy technologies.[10] Such investments, in turn, would also stimulate growth and employment generation.

III. Cooperation of the United Nations system with middle-income countries[11]

A. Major achievements in development cooperation with middle-income countries

29. The operations of the United Nations in middle-income countries are guided by the principles defined in the triennial comprehensive policy review of operational activities for development of the United Nations system (see General Assembly resolution 62/208). Much of its work in middle-income countries focuses on the elimination of disparities, the promotion of equity and social inclusion, assistance in responses to human rights violations, capacity development and advocacy. Advice on policy formulation and implementation, as well as other targeted technical support, are important elements of the United Nations contribution to middle-income countries.

30. According to a survey conducted for the present report, and in recognition of the large number of poor living in middle-income countries, eradicating extreme poverty and hunger (Millennium Development Goal 1) remains a priority in development cooperation between the United Nations system and middle-income countries. Respondents also ranked environmental sustainability and the forging of a global partnership for development (Goals 7 and 8, respectively) as critically important areas for development cooperation. As many middle-income countries have made substantial progress in achieving the health- and education-related Goals, these are lower priorities in efforts to enhance cooperation with the United Nations

[11] Findings in this chapter are based on a questionnaire used in the preparation of document A/64/253, which was disseminated to all United Nations country and regional teams in middle-income countries in June 2009, and a survey disseminated to the Governments of middle-income countries in May 2011. A total of 19 of the 104 middle-income countries surveyed responded to the questionnaire.

system. Respondents further emphasized agricultural and industrial development as key areas where more development cooperation is needed.

31. The survey also revealed that Governments of middle-income countries consider that the United Nations system has made major contributions to development cooperation in terms of capacity development and advice on social policies, good governance, decentralization and local development. These areas coincide with the priority areas identified by United Nations agencies, funds and programmes in their support for development in middle-income countries (see A/64/253). Stakeholders in middle-income countries most value the advocacy and capacity development provided by the United Nations to public officials and non-State actors, along with the sharing of knowledge and experiences of other countries receiving support from the United Nations system. Indeed, the latter is considered a vital component of development cooperation. The United Nations system is seen to be playing a critical role in donor coordination and in helping policymakers to adjust national priorities so as to meet the challenges posed by changing global conditions. To facilitate the exchange of information on middle-income countries at the global and regional levels, the United Nations system periodically organizes conferences focusing on regional cooperation and integration, South-South cooperation and developing trade capacity. The relatively new functions of the Economic and Social Council — conducting the annual ministerial review and organizing the Development Cooperation Forum — also provide platforms for middle-income countries to share their experiences and engage in dialogue with other Member States, civil society and parliamentarians on the Millennium Development Goals and development cooperation.

32. Notwithstanding the achievements of the United Nations system in middle-income countries, and the positive view that Governments have of development cooperation with the United Nations, a number of constraints prevent development cooperation from reaching its full potential in middle-income countries. These include operational constraints, such as overlapping mandates or lack of cooperation among United Nations agencies, funds and programmes, or between the United Nations and Governments, financing constraints, and strategic constraints, which refer primarily to the lack of appropriate or well-defined agendas guiding substantive programmes in middle-income countries (see A/64/253).

33. By and large, the principal strategic constraint facing the United Nations system is the lack of a well-defined, coherent strategic framework that focuses on providing advocacy and policy advice to middle-income countries and that develops capacity in areas that are most relevant to these countries. While different agencies have developed various definitions of middle-income countries, strategies often appear to be determined by resource allocation criteria rather than by substantive or policy priorities.

34. The lack of a coherent development strategy of the United Nations system for middle-income countries was also stressed in the previous report of the Secretary-General on this item (see A/64/253). A number of United Nations agencies and country teams are trying to address this deficiency. For the system at large, the challenge is to ensure that strategies and programmes are tailored to the development needs and priorities of middle-income countries. This requires the United Nations system to reorient its internal planning and coordination processes, including the United Nations Development Assistance Framework, towards greater

participation in national processes. This would help to maintain the focus on results and reduce transaction costs associated with programming.

35. At present, in many regions, the agencies of the United Nations Development Group operate mainly through a network of agency country offices, with technical support provided by their respective headquarters and, increasingly, by the agencies' regional support capacities. For instance, several organizations, including the United Nations Population Fund, the United Nations Development Programme and the World Food Programme, have devolved their regional management and technical support functions in the Arab States and the Middle East and North Africa region by setting up regional centres in Egypt, while the United Nations Children's Fund maintains a regional office in Jordan. While the country office system enables agencies to maintain a close strategic policy dialogue with national counterparts, demands on staff arising from project management and/or related support functions, as well as limited specialist capacities in country offices, often constrain adequate policy dialogue. To address this shortcoming, United Nations country teams and resident coordinators are encouraged to focus more on upstream policy requirements and make more use of the capacities of non-resident agencies available at headquarters.

36. Moreover, United Nations agencies often tend to apply the same intervention model in middle-income countries as the one used in low-income countries. This model involves active engagement in project implementation and providing back-office support and oversight functions. The related interventions are primarily targeted at delivering development benefits directly to beneficiaries at the micro level, and are embedded in a broader programmatic approach aimed at ensuring broader development impact. However, unlike in low-income countries, such interventions tend to be undertaken on a much smaller scale in middle-income countries, which limits the potential for wider impact unless the interventions are an integral part of broader development policies.

B. Engagement of international financial institutions in middle-income countries

37. International financial institutions, including the World Bank Group, the International Monetary Fund (IMF) and a number of regional multilateral banks, remain important partners for development cooperation with middle-income countries. Recent governance reforms of both IMF and the World Bank have recognized the larger weight of developing and transition economies in the world economy, in particular those of middle-income countries, as their shares in voice and voting power in these institutions has increased. In December 2010, the IMF Board of Governors approved quota and governance reforms under the Fourteenth General Review of Quotas. The reforms will shift more than 6 per cent of quota shares to developing countries without lowering the quota shares or voting power of the poorest members. The reforms also envisage an all-elected Executive Board with increased representation of developing countries while maintaining the size of the Board. Meanwhile, the second phase of governance reform for the World Bank Group, agreed in April 2010, increased the voting power of developing countries and economies in transition by between 4.59 and 6.07 percentage points for

different entities in the World Bank Group.[12] However, while there has been some improvement in quota reform, the weight of the basic vote has greatly declined over the decades, diminishing the influence of all but the biggest middle-income country economies. Hence, while recent measures indicate progress, further improvements are needed, including the introduction of an open and transparent senior leadership selection process based on merit, irrespective of nationality and gender, and the promotion of greater management and staff diversity.

38. The international financial safety nets for developing countries have been recently strengthened. In 2010, IMF increased the credit available under the existing Flexible Credit Line, and also established a new Precautionary Credit Line. The former was designed for middle-income countries with policies and economic fundamentals favoured by IMF, while the latter provides contingency protection for countries with moderate vulnerabilities that do not qualify for the Flexible Credit Line, which excludes the vast majority of middle-income countries.

39. While cooperative efforts during the crisis have strengthened global financial safety net, important concerns remain regarding the sufficiency and composition of international liquidity support. Indeed, the crisis highlighted the need for large liquidity buffers to deal with fast and sizable capital market volatility. This requires further strengthening the multilateral capacity to cope with shocks of a systemic nature. In this regard, in the recent crisis, most of the required liquidity was provided through ad hoc arrangements deployed on a one-off basis by key central banks. It has also become evident that uncertainties about the availability and functioning of financial safety nets can impose significant costs.

40. A number of proposals have been made on how to make the global financial safety net more effective and predictable. One ambitious proposal is to extend IMF responsibilities to include the function of international lender of last resort, meaning that the Fund would need adequate resources to be able to provide countries with access to liquidity when no other lender is willing to lend in sufficient volume to deal effectively with a financial crisis.[13] Countries could qualify for access to such funding through regular article IV IMF surveillance without additional conditions.

41. The Fund has also been exploring options for setting up a permanent mechanism to provide liquidity in systemic crises in conjunction with bilateral and regional liquidity support arrangements. Alternative modalities for such a global stabilization mechanism are under consideration, providing varying degrees of predictability and efficacy. Key elements of such a mechanism still need to be defined, such as procedures for activating the mechanism, access to and approval of financing, the instruments involved, the funding of the mechanism, the coordination with relevant central banks and regional arrangements, and safeguards to reduce moral hazard. As a more pragmatic alternative, IMF could take on the role of manager or coordinator of a multilateral network of central bank swap and liquidity lines.

[12] For a more detailed assessment, see the report of the Secretary-General on the international financial system and development (A/66/167).

[13] See, for instance, Eduardo Fernández Arias and Eduardo Levy Yeyati "Global financial safety nets: where do we go from here?", Inter-American Development Bank Working Paper Series No. 231, November 2010.

42. A key element in strengthening the global financial safety net is closer cooperation with regional and subregional mechanisms. Regional financial arrangements, such as the Arab Monetary Fund, the Chiang-Mai Initiative or the Latin American Reserve Fund, can play an important role in preventing and mitigating financial crises. Many middle-income countries play important roles in these regional financial arrangements.

43. Issues concerning middle-income countries' debt sustainability remain in debate. In 2003, the Paris Club adopted its Evian approach, whereby the debt of non-heavily indebted poor countries would be dealt with only in the case of imminent default and as a result of which the resolution of crises would have a longer-lasting impact. It would also formulate, if necessary and in cooperation with IMF, a comprehensive debt workout package for all bilateral official and private creditors. A more systematic reform proposal, the sovereign debt restructuring mechanism, was proposed by IMF but rejected in 2003, owing mainly to opposition from both stakeholders in financial markets and borrowers, who feared that such a mechanism would eventually raise the cost of borrowing. Thus, debt sustainability is currently assessed using the IMF Debt Sustainability Analysis for Market-Access Countries. The framework analyses debt dynamics over a five-year period using a range of scenarios. It implicitly relies on the idea that if the debt-to-GDP ratio is either stable or declining, the solvency condition is met. In contrast, for low-income countries, this framework does not include debt ratio thresholds, since benchmarking could directly influence the premium that borrowers would have to pay on loans. Data for middle-income countries show that 13 per cent of defaults occurred when the external debt-to-GDP ratio fell to below 40 per cent, implying that even if the ratio is low, a default can still occur. Although the framework includes estimates of gross financing needs, it focuses extensively on ratios involving the stock of debt and not on risks arising from the composition of debt or the liquidity situation more generally. For instance, it does not emphasize relevant liquidity indicators, such as the liquid asset position (international reserves to provide cover for the current and capital accounts), or currency and maturity mismatches between debt and the fiscal resources to repay it. The framework should be expanded to include these factors and to monitor more disaggregated and higher-frequency data on debt stock, including short-term and domestic debt.[14]

44. The World Bank has paid significant attention to poverty issues in middle-income countries, including support in making poverty assessments and designing poverty reduction strategies. Most recently, the Bank has made greater efforts to make its business model more responsive, flexible, responsible and innovative. Actions are under way to reduce the cost of doing business with the Bank. Beyond financial and knowledge support, the Bank is also increasing its efforts to work with middle-income countries in a wide array of areas, ranging from climate change and energy security to trade and food production. The World Bank also realizes that it must improve its support to middle-income countries, in particular by jointly developing stronger country partnership strategies with middle-income countries; improving the range of services offered to middle-income countries, notably financial services and blending options; fostering links between Bank research and

[14] For a more detailed discussion, see *MDG Gap Task Force Report 2011: Time to Deliver* (forthcoming, but available from http://un.org/en/development/desa/policy/mdg_gap/index.shtml, from 15 September 2011).

middle-income country needs; and through better management of Bank expertise across all networks.

45. Other multilateral financial institutions, in particular regional development banks, also play important roles in supporting economic development in middle-income countries and assisting in regional integration efforts. This is still true, although more middle-income countries are increasingly relying on international capital markets to secure external financing. The technical support provided by regional development banks, in the form of strategic advice on policies, banking services and asset management, as well as their knowledge and technical assistance services, are of importance to many middle-income countries.

IV. Conclusions and recommendations

46. Despite higher average income levels than in low-income countries, extreme poverty remains high in many middle-income countries. Income inequalities are also higher in this classification than in low- or high-income countries. Eradicating poverty and tackling inequality, therefore, require more effective development cooperation with middle-income countries, especially as most of these countries remain highly vulnerable to external shocks and internal crises.

47. Furthering development cooperation with middle-income countries is also important owing to the positive cross-border and global spillovers from middle- to low-income countries, with a view to providing stability in the international system. The importance of middle-income countries in realizing the United Nations agenda of development for all, including the achievement of the Millennium Development Goals, thus calls for the continued engagement of the United Nations system and other international organizations, including international financial institutions, in development cooperation with middle-income countries.

48. The current development agenda places strong emphasis on the achievement of the Millennium Development Goals, which represent basic social objectives that every country should strive to meet. Although many middle-income countries have already reached, or are on track to reach, the Goals and related targets, they continue to face significant development and capacity challenges in such areas as governance, social inclusion, human rights violations, elimination of disparities, vulnerability of trade, external financing shocks, technology development and transfer, and adaptation and mitigation to tackle the challenges of climate change. The advice of the United Nations on policy formulation and implementation, as well as its other targeted technical support in these areas, are important elements of the Organization’s contribution to middle-income countries.

49. The United Nations system, along with international financial institutions, is widely represented in middle-income countries. While it provides a broad spectrum of development cooperation to these economies, cooperation among agencies and with middle-income countries needs to be strengthened and programme activities must be more closely aligned with the national development strategies and policies of middle-income countries. Moreover, the United Nations system lacks a well-defined agenda and a strategic framework for development cooperation with these countries.

50. The lack of a clear strategy in most middle-income countries is, in part, rooted in the use of per capita income as a criterion for guiding development cooperation. Indeed, while developing countries must take primary responsibility for their own development, consistent with the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action, allocating more official development assistance to poorer countries is, of course, entirely justified. Indeed, consistent with the triennial comprehensive policy review of operational activities for development, least developed countries need continued priority assistance (see General Assembly resolution 62/208, para. 26). In the review, the Assembly also recognized that middle-income countries still faced significant challenges and that efforts to address those challenges should be supported in order to ensure that achievements that had been made to date were sustained.

51. However, the use of per capita income to classify countries as a means of guiding development cooperation disregards the nature and multidimensional nature of development. No two economies are the same, even when they may have the same average per capita level. National development strategies and priorities depend very much on economic conditions and potential. Furthermore, this type of classification ignores the fact that an estimated 75 per cent of the extremely poor live in middle-income countries, and fails to recognize the diversity among, and within, those countries. That diversity extends beyond income status, for example to progress towards the achievement of the Millennium Development Goals, the level of human development, poverty, inequality and other aspects related to their demographic transitions and population sizes. It also ignores the fact that many middle-income countries have not yet fully developed the capacity and capabilities to independently resolve the challenges they face, and that many remain highly vulnerable to external shocks and internal crises, despite having higher levels of per capita income.

52. Although there is no one-size-fits-all approach to development, the United Nations system needs to develop a more specific policy framework for middle-income countries. Among other initiatives, the upcoming independent evaluation of the "Delivering as one" initiative, in particular of the five pilot middle-income countries, is an important step in this direction. The Uruguay high-level conference, to be held in November, will provide an opportunity for an important exchange of experiences among "Delivering as one" pilot countries, including middle-income countries.

53. Any meaningful and appropriate policy framework should recognize these diversities more broadly, rather than mechanically associate a country's stage of development with its per capita income. It should then support countries in their endeavours to further their advancement. The policy framework should recognize that the needs of individual countries will differ and that middle-income countries typically, but not always, have more resources with which to address their development challenges. Under the framework, technical cooperation and other assistance will then need to be provided to enhance the capacities of middle-income countries to (a) transform primary commodity-based economies to promote higher value-added, knowledge-based industrial and modern service economies; (b) diversify exports, in particular in countries that depend on natural resources and primary commodities; (c) increase employment, especially for young people; (d) promote social inclusion and investment in social development so as to address disparities; (e) ensure a consistently countercyclical macrofinancial framework and

policies; (f) strengthen prudential national financial regulation, including capital flow management; and (g) ensure economic, social and environmental policy coherence by means of national development strategies.

54. Several bilateral donors are downsizing or phasing out development assistance contributions to middle-income countries. Hence, it is important that the United Nations strengthen its role in these countries to ensure that their remaining development challenges are addressed effectively, the achieved gains are preserved and decreased financial assistance does not negatively affect their sustainable and inclusive development. This requires setting clear priorities, drawing upon existing capacities in these countries, and brokering new commitments, including increased national and international funding. United Nations agencies, funds and programmes must also streamline and expand their professional practice networks to make their expertise more relevant to their development challenges. They should review whether their country-level capacities and their programming approaches and instruments are attuned to the needs and recognize the characteristics of middle-income countries. Greater use must also be made of the expertise of non-resident agencies.

55. In order to recognize the importance of having a more coherent approach to the development cooperation of the United Nations system with middle-income countries, and to acknowledge that these countries face development challenges that do not always coincide with those of others, Member States may wish to consider establishing a high-level panel or an ad hoc working group, which could elaborate, in greater detail, on the appropriate framework with which to tackle the development challenges of middle-income countries, taking into account their heterogeneity, the positive spillover effects of middle-income countries on the development of low-income countries and the analysis to be undertaken in the context of the upcoming triennial comprehensive policy review of operational activities for development of the United Nations system by the General Assembly.