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MIDDLE-INCOME COUNTRIES: A STRUCTURAL-GAP APPROACH

Note by the secretariat

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FOREWORD

At the thirty-third session of the Economic Commission for Latin America and the Caribbean (ECLAC), which was held in Brasilia in 2010, member States adopted resolution 647(XXXIII), entrusting the secretariat with a new mandate to: (i) continue to analyse, in collaboration with other international and regional intergovernmental agencies, new alternatives for generating the volume of resources necessary for financing the development of the countries of Latin America and the Caribbean; and (ii) develop, in collaboration with other international and regional agencies, a broader set of indicators to reflect the particular realities in the countries and support the identification of their main needs, so that classification as a middle-income country ceases to be an a priori impediment to participation in official development assistance.

In compliance with this mandate, the ECLAC secretariat has prepared the report "Middle-income countries: a structural-gap approach. Note by the secretariat". It argues that constraints and challenges associated with development must not be treated as related in a linear fashion to countries' per capita income levels.

Indeed, the practice of allocating official development assistance on the basis of per capita income presents two main shortcomings. First, poverty alleviation is both cause and effect of development, which is a multifaceted process involving efforts by countries to overcome a wide range of structural gaps that constrain and hinder inclusive growth; indeed, this type of growth is essential for addressing the problems of poverty and inequality. Second, this practice presupposes that the categories of low-, middle- and high-income countries are relatively homogeneous in terms of their economic and social needs, but this is far from the truth.

This document therefore proposes fine-tuning the approach and complementing the per capita income criterion with a new perspective that addresses the structural gaps that constrain the development of middle-income countries (in terms of inequality and poverty, investment and saving, productivity and innovation, infrastructure, education, health, fiscality, gender and the environment); it also recommends opening up a political dialogue among countries, in order to identify ways of dealing with structural gaps by order of priority, with a view to establishing the most appropriate policy mechanisms and strategic working modalities.

This calls for a review of the concept of development used to channel cooperation resources, and the adoption of a broader, multifaceted view which entails not just improving people's standards of living but also achieving sustainable and inclusive growth, whereby the problems of social inequality and productive heterogeneity characteristic of Latin American and Caribbean countries and middle-income countries as a whole can be addressed.

This report presents the findings relating to categories and typologies of countries for consideration by member States; it affirms that by broadening the concept of development and recognizing the wide heterogeneity existing between those classified as middle-income countries and even, within countries themselves, methodological flaws are revealed which result in the vast majority of countries in the region, and more than half of those of the world being placed in the same category. This shows how inappropriate it is to use per capita income as the main criterion for allocating official development assistance within the framework of international cooperation.

ECLAC submits this document to Latin American and Caribbean countries as a contribution to the discussion on a renewed agenda for financing for development at the national, regional, and global levels, in keeping with the requirements of countries.

Alicia Bárcena
Executive Secretary
Economic Commission for Latin America and the Caribbean

I. INTRODUCTION

Per capita income is the principal criterion used in allocating funds for development cooperation. Combining this standard with the Millennium Development Goals, which have dominated the cooperation agenda since the year 2000, has meant that resources are now channelled toward lower-income countries to the detriment of the middle-income group.

As a result, Latin America and the Caribbean, a predominantly middle-income region, has seen a decline in its share of official development assistance (ODA) inflows, both as a percentage of gross national income (GNI) and in comparison with other developing regions. This decline began to steepen in the 2000s.

This trend reflects, on one hand, the decision to concentrate international cooperation funds on combating poverty and its most immediate effects, and thus to give priority to lower-income countries despite the fact that 70% of the world's poor live in middle-income countries. On the other hand, the channelling of funds to lower-income countries reflects the assumption that, as countries increase their per capita incomes, they will have more resources and tools for combating poverty and for financing their own development. Consequently, middle-income countries would supposedly need less support from the international cooperation system. Some authors have referred to this process as “graduation”.

There are two major problems with this approach to allocating development funds. First, overcoming poverty is both a cause and an effect of development. It is a multifaceted process that not only involves improving living standards but also requires attention to a great variety of structural gaps that limit and retard inclusive growth of the kind that can addresses poverty and inequality issues.

Second, this approach assumes that the lower-middle and upper- middle-income countries fall into relatively homogeneous categories. Yet in fact they are very different in terms of poverty rates, social inclusion, and production, institutional and financial capacity. This paper suggests the need to return the countries of Latin America and the Caribbean (and middle-income countries generally) to full participation in the international cooperation system. Instead of straightforwardly equating development constraints with per capita income, this calls for refining the approach and evaluating development needs on the basis of the structural gaps that stand in the way.

In the context of the countries of the region, the starting point is the set of structural gaps (per capita income, poverty, inequality, investment and savings, productivity and innovation, infrastructure, education, health, fiscalilty, gender and environment) identified in *Time for equality: closing gaps, opening trails* (ECLAC, 2010).

What is proposed here is an approach that is both an alternative and a complement to the per capita income approach, one that entails explicitly incorporating into the development cooperation agenda an evaluation of needs and shortcomings that are not captured by income indicators but are reflected in other types of gaps.

An empirical analysis of these gaps shows that countries may be grouped in different ways, depending on the type of gap considered. It also makes clear that classifying countries by putting the per capita income gap before other gaps will not necessarily provide an adequate picture of the needs and vulnerabilities of the countries of the region. Taking this line of thinking, the paper stresses that raising per capita income —and thus narrowing the income gap— does not necessarily mean that the other gaps will improve.

An analysis of the allocation of official development assistance in the region reveals that it has primarily targeted social services and social infrastructure. Aid geared to the social sectors and, in general, those sectors covered by the Millennium Development Goals, does indeed play an important role. But the gaps analysis finds that the obstacles holding back the development of middle-income countries are greater and more varied and that these countries differ in terms of their capacities to address them.

If structural gaps are to be used to establish criteria for the distribution of international cooperation funds, there must be new forums for dialogue on a global development agenda. These forums should make it possible to identify and prioritize development gaps and yield proposals for international cooperation system policies and mechanisms that complement existing tools for dialogue, which are more focused on the system's effectiveness and accountability. Policy dialogue should also identify and establish cooperation modalities in light of the gaps that are flagged as priorities. The Latin American Investment Facility (LAIF) is a prime example of a mechanism whereby the countries of the region can address the infrastructure gap. It is based on limited "seed" funding from the European Commission intended to attract much larger loans from the European Investment Bank, the Inter-American Development Bank (IDB) and bilateral sources, which are then channelled into infrastructure projects (physical or energy related, among others) in the region.

A better understanding of the development obstacles facing each country, together with systematic dialogue between donor and recipient for jointly deciding priority areas, would provide clearer direction for development assistance and, in general, would make cooperation policies more effective. This is an approach that will open the way for improving the channelling and allocation of official development assistance and for actively incorporating all middle-income countries into the international cooperation system.

Lastly, the paper argues that greater participation by middle-income countries in the cooperation system, whether as donors or recipients, can have a positive impact on growth and on global development because of their economic and social weight in the world economy and consequently the enormous positive externalities for global growth and well-being that will flow from cooperation with these countries.

A. PER CAPITA INCOME LEVELS AND MIDDLE-INCOME COUNTRIES

Per capita income constitutes the principal criterion for grouping countries according to their level of development, and thus for allocating international cooperation flows.[1] The World Bank, for example, while recognizing that development is not exclusively a question of incomes, uses gross national income (GNI) per capita to establish income thresholds and to classify countries into four groups: low-income, lower-middle-income, upper-middle-income, and high-income.[2]

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1 Some agencies apply alternative criteria: the United Nations Development Programme (UNDP), for example, uses the Human Development Index (HDI) to assess countries' development level. This index relies on three indicators: life expectancy at birth (years); educational level (measured as a combination of the literacy rate among the population aged 15 years and over, the combined primary, secondary and tertiary gross enrolment rate in) and per capita GDP (see http://www.pnud.org.co/sitio.shtml?apc=aBa020081--&volver=1).

2 Economies are divided according to 2010 per capita GNI, calculated using the World Bank Atlas Method. The groups are: low-income, US$ 1,005 or less; lower-middle income, US$ 1,006 - US$ 3,975; upper-middle income, US$ 3,976 - US$ 12,275; and high-income, US$ 12,276 or more. See [online] http://data.worldbank.org/about/country-classifications).

The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) takes the same indicator to distinguish two broad groups of countries in order to establish an objective criterion for allocating official development assistance (ODA). Developed countries (essentially those ranked as high-income countries in the World Bank classification) and developing countries (least developed countries; low-income, lower-middle and upper-middle-income countries).

There is considerable overlap between the World Bank and DAC criteria as applied to Latin America and the Caribbean. Of all the countries in the region only three (Bahamas, Barbados and Trinidad and Tobago) are “developed” according to DAC or are “high-income” according to the World Bank. Of the remaining 30 developing countries, only one (Haiti) is classified as low-income according to the World Bank (least developed according to DAC), eight are ranked as lower-middle-income countries according to both criteria and 21 are classed as upper-middle-income countries, again under both criteria (see table 1).

Table 1

LATIN AMERICA AND THE CARIBBEAN: COUNTRY CLASSIFICATION ACCORDING TO WORLD BANK AND OECD DEVELOPMENT ASSISTANCE COMMITTEE

		World Bank	**DAC**	**Subregion**
1	Bahamas	High-income	Developed country	Caribbean
2	Barbados	High-income	Developed country	Caribbean
3	Trinidad and Tobago	High-income	Developed country	Caribbean
4	Antigua and Barbuda	Upper-middle-income	Developing country, upper-middle-income	Caribbean
5	Argentina	Upper-middle-income	Developing country, upper-middle-income	Latin America
6	Brazil	Upper-middle-income	Developing country, upper-middle-income	Latin America
7	Chile	Upper-middle-income	Developing country, upper-middle-income	Latin America
8	Colombia	Upper-middle-income	Developing country, upper-middle-income	Latin America
9	Costa Rica	Upper-middle-income	Developing country, upper-middle-income	Latin America
10	Cuba	Upper-middle-income	Developing country, upper-middle-income	Latin America
11	Dominica	Upper-middle-income	Developing country, upper-middle-income	Caribbean
12	Ecuador	Upper-middle-income	Developing country, upper-middle-income	Latin America
13	Grenada	Upper-middle-income	Developing country, upper-middle-income	Caribbean
14	Jamaica	Upper-middle-income	Developing country, upper-middle-income	Caribbean
15	Mexico	Upper-middle-income	Developing country, upper-middle-income	Latin America
16	Panama	Upper-middle-income	Developing country, upper-middle-income	Latin America
17	Peru	Upper-middle-income	Developing country, upper-middle-income	Latin America
18	Dominican Republic	Upper-middle-income	Developing country, upper-middle-income	Latin America
19	Saint Vincent and the Grenadines	Upper-middle-income	Developing country, upper-middle-income	Caribbean
20	Saint Kitts and Nevis	Upper-middle-income	Developing country, upper-middle-income	Caribbean
21	Saint Lucia	Upper-middle-income	Developing country, upper-middle-income	Caribbean
22	Suriname	Upper-middle-income	Developing country, upper-middle-income	Caribbean
23	Uruguay	Upper-middle-income	Developing country, upper-middle-income	Latin America
24	Venezuela (Bolivarian Republic of)	Upper-middle-income	Developing country, upper-middle-income	Latin America
25	Belize	Lower-middle-income	Developing country, lower-middle-income	Caribbean
26	Bolivia (Plurinational State of)	Lower-middle-income	Developing country, lower-middle-income	Latin America
27	El Salvador	Lower-middle-income	Developing country, lower-middle-income	Latin America
28	Guatemala	Lower-middle-income	Developing country, lower-middle-income	Latin America
29	Guyana	Lower-middle-income	Developing country, lower-middle-income	Caribbean
30	Honduras	Lower-middle-income	Developing country, lower-middle-income	Latin America
31	Nicaragua	Lower-middle-income	Developing country, lower-middle-income	Latin America
32	Paraguay	Lower-middle-income	Developing country, lower-middle-income	Latin America
33	Haiti	Lower income	Least developed	Latin America

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of S. Tezanos Vázquez, “Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo”, *Financiamiento del desarrollo series*, Santiago, Chile, 2012, forthcoming; and Development Assistance Committee (DAC), “DAC List of ODA Recipients”, 2011 [online] http://www.oecd.org/dac/stats/daclist.

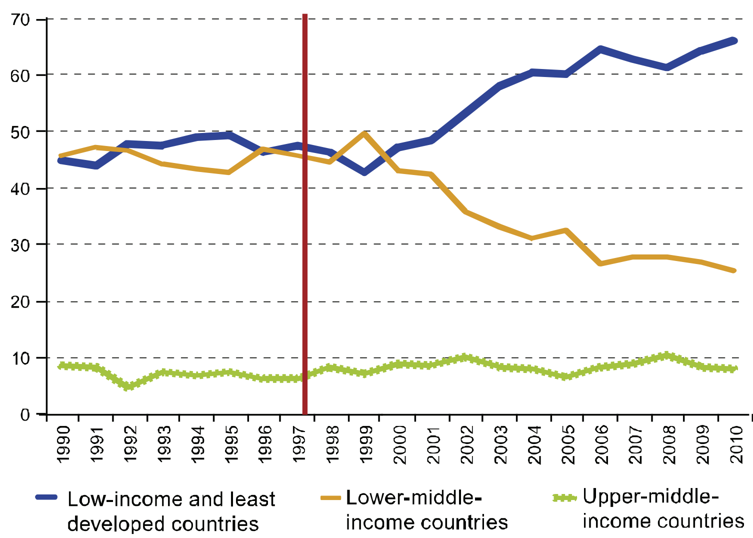
On the basis of per capita income, then, Latin America and the Caribbean is a predominantly middle-income region. This has meant that, as will be seen in the next section, the official development assistance received by the region has been declining steeply, both in terms of regional gross national income (GNI) and in comparison with other developing regions. This decline has been sharper since the 2000s, when the Millennium Development Goals were approved as the principal international development agenda.

B. OFFICIAL DEVELOPMENT ASSISTANCE TRENDS IN LATIN AMERICA AND THE CARIBBEAN

Using the per capita income classification to track ODA flows during the period 1990-2010 shows that ODA has become increasingly concentrated in the low-income category. In 1990, around half of ODA flows went to the low-income and the least developed countries. Two decades later, in 2010, this group was receiving more than 65% of ODA flows.

The consequence of channelling more of these flows to low-income countries is that the share and the absolute volume of ODA received by middle-income countries have been declining steadily. In 1990, middle-income countries received on average a greater portion of ODA than did low-income countries (55% versus 45%). By 2010, the share of middle-income countries had dropped significantly, and they were receiving only half the volume of ODA flowing to low-income and least developed countries (see figure 1).

Figure 1
SHARE OF TOTAL NET OFFICIAL DEVELOPMENT ASSISTANCE DISBURSEMENTS, BY INCOME CATEGORY, 1990-2010
(Percentages)



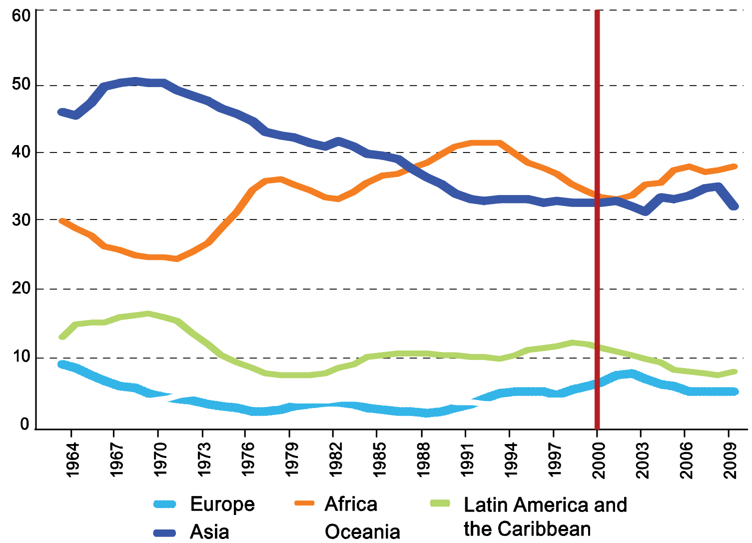
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD).

Like other middle-income regions, Latin America and the Caribbean has also seen a significant drop in ODA inflows. During the 1960s the region received on average about 14% of total ODA to developing countries, while the figure currently stands at around 8% (see figure 2). Of the US$ 131 billion disbursed to developing countries in 2010, the region received only US$ 10.8 billion.

Figure 2

SHARE OF THE REGIONS IN OFFICIAL DEVELOPMENT ASSISTANCE DISBURSEMENTS, 1964-2009

(Moving five-year averages, percentages)



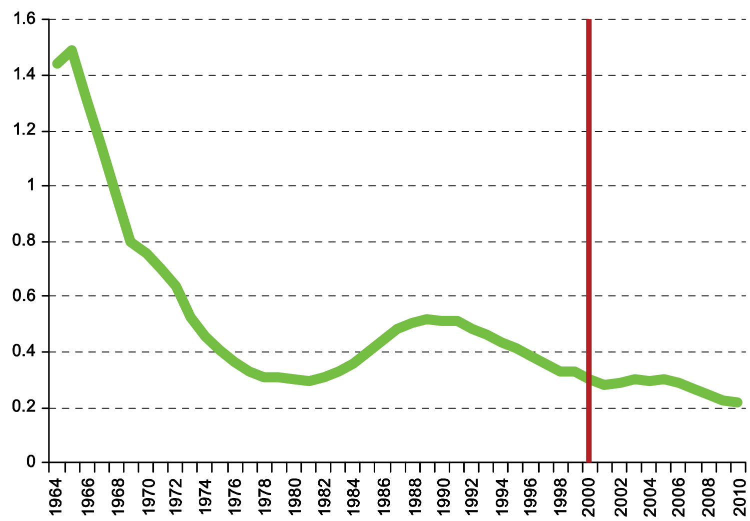
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from the Organization for Economic Cooperation and Development (OECD).

ODA flows to Latin America and the Caribbean represented more than 1% of the region's GNI during the 1960s, falling to 0.4% in the 1990s and to 0.22% today (see figure 3).

Figure 3

NET OFFICIAL DEVELOPMENT ASSISTANCE RECEIVED BY LATIN AMERICA AND THE CARIBBEAN AS A PERCENTAGE OF GROSS NATIONAL INCOME, 1964-2010

(Moving five-year averages, 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 pattern of ODA allocation based on income and weighted in favour of low-income countries has been reinforced in part by the international cooperation system's push to achieve the Millennium Development Goals, as per capita income and Millennium Development Goal indicators are often closely related.[3] Since the year 2000 there has been a marked tilt in the worldwide allocation of ODA in favour of low-income and least developed countries. This thrust, as noted earlier, has come at the expense of middle-income countries, whose share of assistance is dropping steadily.

C. ODA FLOWS TO THE COUNTRIES OF THE REGION

Between 2003 and 2010, net ODA disbursements to the countries of Latin America and the Caribbean as a whole averaged slightly more than US$ 7 billion yearly –equivalent to 0.22% of regional GNI. These aggregate figures conceal inter-country disparities in terms of GNI and in terms of per capita assistance received. For example, in GNI terms, ODA receipts were very important during this time in Haiti and Nicaragua (accounting for more than 15% of GNI), followed by Dominica and the Plurinational State of Bolivia (more than 5% in both cases). On the other hand, the contribution was very modest for the remaining countries (less than 1% of GDP in 16 of the 30 countries). These ODA discrepancies are even more marked in population terms: seven countries (most of them with small populations) are receiving contributions of more than US$ 150 per capita (Dominica, Grenada, Guyana, Nicaragua, Saint Kitts and Nevis, Saint Vincent and the Grenadines, and Suriname); by contrast, contributions to the most populous countries of the region (Brazil and Mexico) amount to less than a dollar and a half per head (Tezanos, 2012; see table 2).[4]

In terms of the sectoral concentration of ODA, there has been a steady trend since the 1990s to redirect ODA allocations away from economic infrastructure and general development (for example structural adjustment assistance programmes) toward social services and social infrastructure sectors (see United Nations, 2005). These sectors were already receiving around 34% of new ODA commitments to the countries of the region during the 1990s; for 2003 to 2010 this figure averaged 49% of commitments and 42% of gross disbursements (see figure 4).

Thus, for the region as a whole, it is the social infrastructure and services sector that has received the greatest volume of ODA, with particular emphasis in recent years on government and civil society and "other" subsectors, the last item including employment and housing policies as well as narcotics control,[5] among other matters. There has been a slight decline in the proportion of funding allocated to basic social services, covered by Millennium Development Goals indicator 34 (basic education, basic health, nutrition, water and sanitation). In the mid-1990s these subsectors accounted for 38% of total allocations to the social sectors, whereas the proportion stood at around 30% in the period 2003-2010.

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3 At the Millennium Summit, 189 countries committed to make maximum efforts to eradicate poverty and hunger and to promote education, health, gender equality and environmental sustainability. Those commitments were reflected in the Millennium Declaration in the form of eight goals toward which the international community must strive: the Millennium Development Goals. The United Nations prepared a document establishing a full list of targets and indicators for monitoring the goals. The eight Millennium Development Goals translated into 18 targets, with some 48 indicators for tracking them (Alonso, 2007).

4 This confirms the "tilt in favour of small countries" reflected in the global ODA distribution map (Tezanos, 2008).

5 Cooperation for narcotics control is particularly important in Colombia, where it is financed primarily by the United States as part of the Andean Counterdrug Initiative (Tezanos, 2012).

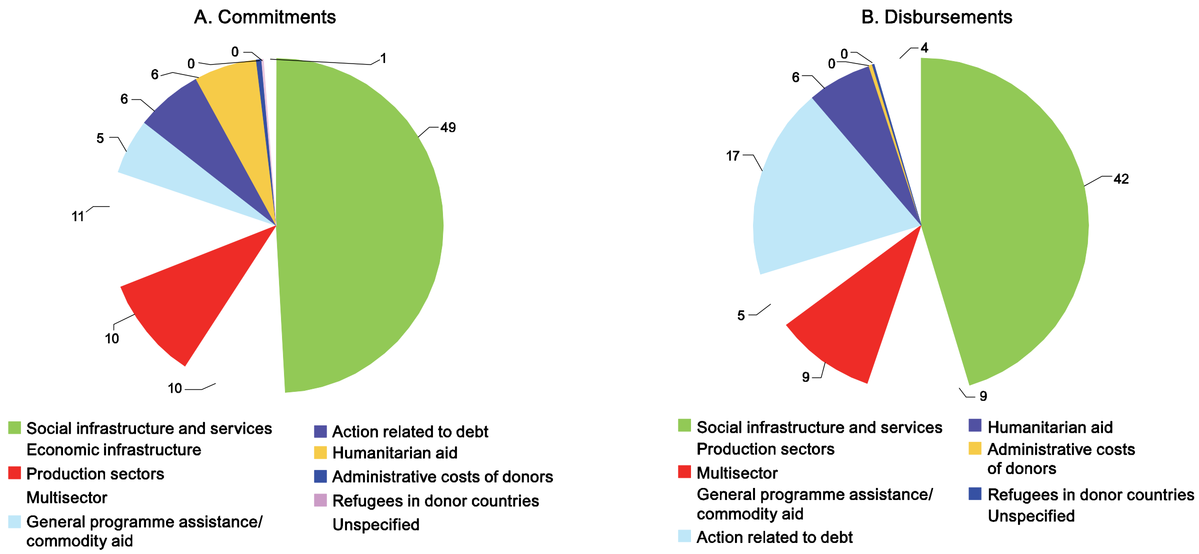
Table 2
LATIN AMERICA AND THE CARIBBEAN: PRINCIPAL ODA FIGURES, AVERAGES FOR 2003-2010

	ODA/GNI *(percentages)*	**Per capita ODA** *(dollars)*	**Average annual ODA** *(millions of dollars)*
Antigua and Barbuda	0.80	92	8
Argentina	0.05	3	128
Belize	1.57	59	18
Bolivia (Plurinational State of)	5.68	85	794
Brazil	0.03	2	332
Chile	0.09	7	123
Colombia	0.46	20	878
Costa Rica	0.22	13	58
Cuba	0.29	10	113
Dominica	7.76	373	26
Dominican Republic	0.30	13	120
Ecuador	0.44	16	214
El Salvador	1.13	38	231
Grenada	5.72	309	32
Guatemala	1.19	30	401
Guyana	9.24	211	158
Haiti	19.29	98	937
Honduras	4.88	85	602
Jamaica	0.63	28	74
Mexico	0.02	2	211
Nicaragua	15.67	165	913
Panama	0.14	9	31
Paraguay	0.74	15	90
Peru	0.37	15	408
Saint Kitts and Nevis	2.08	188	9
Saint Lucia	2.17	115	19
Saint Vincent and the Grenadines	4.42	206	23
Suriname	4.30	170	86
Uruguay	0.14	10	35
Venezuela (Bolivarian Republic of)	0.03	3	69
Total Latin America and Caribbean	**0.22**	**14**	**7 141**

Source: S. Tezanos Vázquez, "Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo", *Financiamiento del desarrollo series*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2012, forthcoming.

Note: ODA/GNI: ratio between aggregate ODA (net disbursements) over the period (current dollars) and aggregate GNI over the period (current dollars). ODA per capita: ratio between aggregate ODA (net disbursements) over the period (constant 2009 dollars) and aggregate population over the period. Average annual ODA: annual average of net ODA disbursements over the period 2003-2010 (constant 2009 dollars). Total Latin America and the Caribbean includes the 29 middle-income countries of Latin America and the Caribbean, plus Haiti.

Figure 4
LATIN AMERICA AND THE CARIBBEAN (30 COUNTRIES): ODA COMMITMENTS AND DISBURSEMENTS FROM TOTAL DONORS, BY SECTOR, AVERAGE FOR THE PERIOD 2003-2010
(All donors, on the basis of constant 2009 dollars in percentages)



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

Naturally enough, the volume of ODA targeted at the social sectors and aimed directly at sectors covered by the respective Millennium Development Goal has been relatively high. Yet it will become clear in the discussion below that the challenges facing the development of middle-income countries in Latin America and the Caribbean do not end there. In fact, as has been shown by a number of case studies on cooperation with middle-income countries presented by Freres, Martínez and Angulo (2010), the governments of the region, while still committed to achieving the Goals, view these challenges in a broader context that embraces the entire development process. It is this broader set of issues, as this paper will argue, that deserves international cooperation support in its various forms and modalities.

D. ARGUMENTS FOR COOPERATION WITH MIDDLE-INCOME COUNTRIES: DEVELOPMENT AS A BROAD CONCEPT

As noted earlier, the international cooperation system excludes middle-income countries such as those of Latin America and the Caribbean, since it operates on a rationale of per capita income levels as a proxy for development.

Yet the level of development cannot be identified solely on the basis of income. The concept of development extends well beyond the increase in per capita income. It is a broad and multifaceted concept that envisions not only improving living standards but also achieving sustainable and inclusive growth that addresses the social and economic inequalities that characterize the countries of Latin

America and the Caribbean and, in general, those in the middle-income bracket. It also implies fostering conditions to create and establish political, economic and social systems that will promote respect, diversity, human dignity and equality.

From this viewpoint, using income levels to classify countries is a blinkered and, in a sense, reductionist approach because it groups together countries whose economic and social circumstances are very —and sometimes radically— distinct and heterogeneous in terms of the development challenges they pose.

This is what happens with a very broad group of countries that are, on this basis, included in the middle-income category.

Currently, more than half of all countries belong to the middle-income group, and they account for more than 70% of the world population.[6] In such a broad group there are of course many different realities, both in terms of needs and vulnerabilities and in terms of capacities and potential. In fact, countries classified as middle-income differ greatly not only in their size and social conditions but also in the economic and structural circumstances that determine their potential for development and production performance.[7] To group countries by income level overlooks these differences and ignores the great similarity between many of their problems and those of the countries classed as low-income (ECLAC 2010b, 2011).

The countries of Latin America and the Caribbean are a clear example. The roster of upper-middle or lower-middle-income countries neither explains nor pinpoints the profound differences that exist not only between these two subgroups but also within them. If socioeconomic variables such as per capita income, income distribution inequality and poverty level are considered, the variation interval width clearly reveals differences between countries. As can be seen in table 3, the per capita income of countries of the region classed as lower-middle-income ranges from a minimum of US$ 2,329 to a maximum of US$ 6,250. The interval is even wider for those classed as upper-middle-income: a minimum of US$ 6,077 and a maximum of US$ 16,407. In terms of the Gini index (an indicator of income inequality), there are also significant variation intervals, with a minimum of 44.5 and a maximum of 57.7 for lower-middle-income countries and a minimum of 42.4 and a maximum of 58.4 for upper-middle-income countries. The poverty index, measured at an income threshold of two dollars a day, ranges from a minimum of 13.2 to a maximum of 35.4 in lower-middle-income countries and from a minimum of zero to a maximum of 40.6 in upper-middle-income countries.

Inter-country differences are also significant when weighing structural features related to performance in terms of productivity and participation in world trade, among many others. This applies for the middle-income category not only in Latin America and the Caribbean but at the global level (ECLAC, 2011).

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6 Middle-income countries 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) (ECLAC, 2011).

7 This is not surprising, considering that the middle-income group has per capita incomes ranging from US$ 1,006 to US$ 12,275 and is therefore broad enough to accommodate many different realities.

Table 3
LATIN AMERICA AND THE CARIBBEAN (29 MIDDLE-INCOME COUNTRIES): SELECTED SOCIOECONOMIC VARIABLES
(Dollars and percentages)

Variable	Number of observations	Minimum	Maximum	Mean	Standard deviation
Lower-middle-income countries					
Per capita GDP *(in PPP dollars)*	8	2 329	6 250	4 006	1 390
Gini index (0-100)	8	44.5	57.7	52.3	4.7
Poverty rate *(percentages)*	8	13.2	35.4	23.3	7.8
Upper-middle-income countries					
Per capita GDP *(in PPP dollars)*	20	6 077	16 407	9 125	2 654
Gini index (0-100)	15	42.4	58.4	49.2	4.6
Poverty rate *(percentages)*	15	0	40.6	12.7	11.3

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 referring to GDP per capita are measured in terms of purchasing power parity (PPP) and are averages for the period 2003-2007; consequently they should not have been affected by the global crisis that began in 2008. The poverty rate is based on the threshold of two dollars a day and corresponds to the last available data, as information for some years is lacking. The Gini index is used to measure income inequality and ranges from a minimum of zero (lowest inequality) to a maximum of 100 (highest inequality). It also reflects the last available data. The classification of countries by income group is the most recent from the World Bank.

There are a great many countries that have been progressing toward higher per capita income levels —and are thus classified as middle-income— but that still face many development challenges that are not captured using the per capita income approach.

The international cooperation system needs to address the many vulnerabilities and unmet needs of countries thus excluded.

For this reason, ECLAC maintains that the mindset governing the current international cooperation agenda should be revised, and that a crucial step in this direction would be to adopt a new approach that can sharpen the focus and pinpoint the greatest development challenges in each case. This fresh focus, in turn, would be the basis for reaching consensus on a new and inclusive development cooperation agenda that incorporates the challenges of all countries, without excluding those that are classified as middle-income.

E. SHARPENING THE FOCUS: A GAP-BASED APPROACH TO VULNERABILITIES

The income-gap approach and the development agenda associated with this concept, the core of which is enshrined in the Millennium Development Goals, do not reflect the multifaceted nature of development as ECLAC understands it or the true structural challenges facing middle-income countries such as those of Latin America and the Caribbean.

This paper proposes an alternative, inclusive and integrated approach for evaluating long-term challenges and areas of greatest vulnerability in countries of the region.

In *Time for equality: closing gaps, opening trails*, ECLAC posits that achieving development requires overcoming endemic production lags through innovation and investment in physical and, especially, human capital in order to boost systemic productivity and competitiveness, as well as strengthening institutions and consolidating democracies. This means addressing a number of obstacles —or, more precisely, structural development gaps— that still persist and that not only impede vigorous and sustainable economic growth in the countries of the region but also limit the potential for moving towards more inclusive economies and societies.

These gaps include those of (i) per capita income, (ii) inequality, (iii) poverty, (iv) investment and savings, (v) productivity and innovation, (vi) infrastructure, (vii) education, (viii) health, (ix) fiscality, (x) gender, and (xi) the environment (see box 1). This focus on gaps encompasses not only the income gap and other concerns on the Millennium Development Goals development agenda but also incorporates many other areas that typify some of the region's principal development challenges.

Consequently, identifying and quantifying the relative magnitude of these gaps for each country is an essential first step for determining where the greatest challenges for the region's economies lie and which areas should be incorporated into a new development cooperation agenda.

Box 1

LATIN AMERICA AND THE CARIBBEAN: DEVELOPMENT GAPS DEFINED IN *TIME FOR EQUALITY: CLOSING GAPS, OPENING TRAILS*

Per capita income gap

The region's per capita GDP over the period from 1990 to 2008, when the global crisis erupted, shows meagre growth of 1.7%. This figure is well below that recorded in East Asia (4.1%) and the same as in the United States, where per capita income is almost five times as high as in Latin America and the Caribbean. This means that the per capita GDP gap between the countries of the region and developed countries, far from shrinking, is in fact growing.

Equality gap

While there have been improvements in recent years, most Latin American and Caribbean societies are still marked by profound social inequality that, in turn, reflects their strong concentration of property ownership and striking production heterogeneity. The inequality of income distribution in the countries of the region can be appreciated by comparing income levels between the richest and poorest population deciles. Average income per head for households in the tenth decile is 34 times that for the poorest decile; by way of comparison, for G7 countries this ratio is 12 to 1.

Poverty gap

Despite some years of progress in reducing poverty, the region has not overcome this scourge, which is exacerbated by extreme income distribution inequality arising from great inequalities of origin, a low tax burden, poor government redistributive capacity and inefficient and unequal labour markets that tend to reinforce initial inequalities —those of class, gender, age or ethnic background.

Investment and savings gap

The rate of capital formation, a fundamental element for sustained growth, has been very low in the region compared with the rate observed in other successful emerging economies. Domestic savings, which should be key for financing development, have also stagnated at levels much lower than those for other developing regions as a percentage of GDP. While foreign capital (external savings) can contribute greatly to domestic savings in financing investment, it must be longer-term and not be erratic or destabilizing.

Productivity and innovation gap

Social gaps cannot be understood without a grasp of the uneven quality and productivity of jobs among (and within) economic sectors, which translates into widely different worker, capital and labour force performance. Productivity gaps reflect, and in turn reinforce, gaps in terms of capacities, incorporation of technical progress, access to social safety nets and job opportunities for upward mobility in the course of working life. To the extent that low-productivity sectors find it enormously difficult to innovate, adopt technology and encourage learning, internal heterogeneity aggravates the problems of systemic competitiveness, generating vicious circles not only of poverty and low growth but also of slow learning and inadequate structural change.

Box 1 (concluded)

Productivity improvements are closely related to greater production investment and greater capacity to close the technological and innovation gap with more advanced countries. Yet in this respect the region's innovation policies face a major challenge. Together with other policies (industrial, education and macroeconomic), they must contribute to fostering an atmosphere for rapid learning and structural change in favour of technologically more dynamic sectors. To date, the trends are not encouraging. When it comes to investment in research and development, even the most advanced countries of the region have not achieved the level of European countries, the United States or Japan, where research and development represents between 2% and 3.6% of GDP. In many countries of Latin America and the Caribbean, research and development spending does not exceed 0.5% of GDP.

Infrastructure gap

There are still great infrastructure gaps in the region, and urgent needs for more physical capital. In several countries the fiscal adjustments made in recent decades have dampened public investment and deepened the gap with countries that did not neglect this type of investment. To encourage an economy based on production development it is important to avoid public investment bias in government budgets; otherwise, infrastructure investment will suffer.

Education gap

Education is a multifaceted springboard for development. A society with higher education levels will be better equipped to take prompt advantage of technical progress, innovation and gains in competitiveness and productivity. Education plays a decisive role in achieving equality. Learning that is less segmented by socioeconomic level, gender, territory and ethnic origin will help reduce equality gaps from one generation to the next. A strategy to achieve equality in education must give priority to expanding the coverage of preschool education and lengthening the school day in public schools, improving secondary completion rates among socioeconomic sectors with lower achievement levels, and reducing the learning and knowledge gaps built up over the education cycle. In this regard there are still substantial gaps between countries: while on average the region is very close to universal coverage and most children complete primary school, the completion rates for secondary school and rates of tertiary education access and completion still betray serious shortcomings as well as marked stratification. For example, the average secondary school completion rate is very low (51%), particularly for the lowest income quintile (22%). There are also deep gaps in terms of what Latin American students actually learn, and these become apparent in comparing students' standardized test results with those in developed countries.

Health gap

A society that universalizes timely access to health care will reduce the costs associated with disease, from lower productivity to sickness-related expenditure. Yet access to healthcare benefits and systems of insurance against risk and vulnerability is still highly segmented in the region. This segmentation, in turn, is a crucial factor exacerbating the equality gap.

Fiscal gap

Significant and sustainable improvements in poverty reduction and income distribution in Latin America and the Caribbean will not be made without active tax policies that boost the quality and distributive potential of markets. In most countries of the region, it is clear that the current tax burden and tax structure are not appropriate for modernizing production structures and achieving greater social equality.

Gender gap

Inequalities in the areas of education, social protection and productivity are sustained by, and feed into, historic divides that exist by reason of race, ethnic background, gender and geography. Gender inequalities are expressed, on one hand, in various forms of discrimination in the workplace (lower incomes, higher unemployment and less job security) and, on the other hand, in the unpaid and unrecognized care economy that is vital to the reproduction of society and is shouldered largely by women.

Environmental gap

The countries of the region still have a long way to go to make their development patterns compatible with production convergence that is sustainable over time. Environmental sustainability must be preserved via structural change that will reduce productivity differentials with more developed countries. This scenario, referred to as sustainable convergence, will require countries to make conscious efforts to give the environment a central place in their development strategy.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), *Time for equality: closing gaps, opening trails* (LC/G.2432(SES.33/3)), Santiago, Chile, 2010.

F. DEVELOPMENT-GAP BASED CLASSIFICATIONS OF THE MIDDLE-INCOME COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN

1. Different gaps mean different classifications: Gauging development needs is not a one-size-fits-all proposition

In order to evaluate development needs at the country level, a set of indicators was selected that, to the extent possible, serve as a proxy variable for each of the gaps described (see table 4); the width of each variable was evaluated for each country.[8]

The analysis shows, first, that the ranking and classification of countries by income gap does not coincide with the classification obtained on the basis of other gaps (see table 5).[9] This confirms the idea that a country classification based solely on the per capita income gap offers only a partial and subjective picture of real needs and vulnerabilities. In other words, the analysis shows that income level cannot be equated with development level, because an increase in income and hence a reduction in the income gap does not necessarily mean an improvement in the other gaps.

Table 4
INDICATORS USED AS PROXIES FOR DEVELOPMENT GAPS

Development gap	Proxy indicator	Source	Method of preparation	Period
1. Per capita income gap	1.1 GDP per capita (PPP in dollars)	World Bank	Average	2003-2007
2. Inequality gap	2.1 Gini index	World Bank	Last year available	
3. Poverty gap	3.1 Poverty rate (2 dollars a day, PPP) (percentage of population)	World Bank	Last year available	
4. Investment and savings gap	4.1 Gross capital formation per capita (dollars at constant 2000 prices)	World Bank	Average	2003-2007
	4.2 Gross domestic savings (percentage of GDP)	IMF	Average	2003-2007
5. Productivity and innovation gap	5.1 GDP per worker (PPP in dollars)	Heston *et al*. (2011)	Average	2003-2007
	5.2 Academic articles (per million inhabitants)	World Bank	Average	2003-2007
6. Infrastructure gap	6.1 Overall logistics performance index (1= low; 5=high)	World Bank		2006
7. Education gap	7.1 Average years of schooling (persons aged 25 and over)	World Bank	Average	2005
8. Health gap	8.1 Assisted childbirths (percentage of total)	World Bank	Last year available	
9. Fiscal gap	9.1 Government net financing capacity/needs (percentage of GDP)	IMF	Average	2003-2007
	9.2 Government revenues (percentage of GDP)	IMF	Average	2003-2007
10. Gender gap	10.1 Gender inequality index	UNDP	Last year available	
11. Environmental gap	11.1 Rate of change in forest area	World Bank	Simple rate of change	1990-2010

Source: S. Tezanos Vázquez, "Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo", *Financiamiento del desarrollo series*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2012, forthcoming.

Note: PPP: purchasing power parity.

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8 Two criteria were used in selecting these proxies: those that best reflect the gap in question, and those that were available for the greatest number of middle-income countries in the region.

9 This analysis included 21 of the 29 middle-income countries of the region and excluded another eight because the necessary information was unavailable. The latter are Cuba, Suriname and six small island States of the Caribbean (Antigua and Barbuda, Dominica, Grenada, Saint Vincent and the Grenadines, Saint Kitts and Nevis, and Saint Lucia). The 21 countries included represent 72.4% of the target countries for this analysis and 97.9% of the target population (Tezanos, 2012).

Table 5
LATIN AMERICA AND THE CARIBBEAN (21 COUNTRIES): GAP-BASED RANKING OF MIDDLE-INCOME COUNTRIES

Bigger gap

	Per capita income gap	Inequality gap	Poverty gap	Investment and savings gap		Productivity and innovation gap		Infrastructure gap	Education gap	Health gap	Fiscal gap	Gender gap	Environmental gap
				Investment	Savings	Productivity	Innovation						
Bigger gap	NIC	COL	HND	BOL	GUY	NIC	DOM	GUY	GTM	GTM	GTM	GTM	HND
	GUY	HND	NIC	GUY	BLZ	BOL	SLV	NIC	NIC	HND	CRI	GUY	NIC
	HND	BOL	COL	NIC	SLV	PRY	HND	JAM	VEN	BOL	DOM	HND	SLV
	BOL	BLZ	BOL	PRY	NIC	GUY	PRY	BOL	HND	NIC	SLV	NIC	GTM
	PRY	BRA	BLZ	GTM	PAN	HND	GTM	DOM	DOM	PRY	PER	BLZ	ECU
	GTM	GTM	GTM	HND	GTM	PER	NIC	COL	BRA	PER	MEX	PAN	PRY
	SLV	PAN	GUY	SLV	DOM	ECU	ECU	HND	SLV	PAN	PRY	SLV	ARG
	BLZ	CHL	SLV	ECU	JAM	SLV	BOL	URY	COL	GUY	PAN	COL	PAN
	PER	NIC	PER	PER	URY	GTM	PER	GTM	PRY	MEX	HND	DOM	BLZ
	ECU	PRY	DOM	DOM	BRA	BRA	BLZ	BLZ	ECU	JAM	BLZ	BOL	VEN
	DOM	MEX	ECU	BLZ	CRI	COL	GUY	CRI	MEX	ARG	CHL	PRY	BRA
	JAM	CRI	PRY	JAM	COL	PAN	COL	PRY	CRI	BLZ	COL	ECU	BOL
	COL	ECU	VEN	COL	PER	URY	JAM	ECU	URY	VEN	ECU	JAM	MEX
	BRA	DOM	BRA	BRA	BOL	DOM	PAN	VEN	GUY	SLV	JAM	BRA	COL
	CRI	PER	PAN	URY	PRY	VEN	VEN	SLV	BOL	COL	GUY	MEX	PER
	PAN	SLV	MEX	PAN	HND	JAM	CRI	BRA	ARG	BRA	ARG	VEN	JAM
	URY	ARG	JAM	CRI	CHL	ARG	MEX	PER	BLZ	DOM	BOL	PER	DOM
	VEN	JAM	CRI	MEX	ARG	CRI	BRA	MEX	PAN	ECU	NIC	CHL	GUY
	ARG	GUY	ARG	VEN	MEX	BLZ	URY	PAN	JAM	CRI	URY	ARG	CRI
	CHL	VEN	URY	CHL	ECU	CHL	ARG	ARG	PER	URY	VEN	CRI	CHL
Smaller gap	MEX	URY	CHL	ARG	VEN	MEX	CHL	CHL	CHL	CHL	BRA	URY	URY

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: ARG: Argentina; BOL: Bolivia (Plurinational State of); BRA: Brazil; CRI: Costa Rica; CH: Chile; DOM: Dominican Republic; ECU: Ecuador; GTM: Guatemala; GUY: Guyana; HND: Honduras; JAM: Jamaica; MEX: Mexico; NIC: Nicaragua; PAN: Panama; PER: Peru; PRY: Paraguay; SLV: El Salvador; URY: Uruguay; VEN: Venezuela (Bolivarian Republic of). The indicators in table 4 were proxy variables for each of the gaps. In the case of the fiscality gap, the ranking reflects only the government revenue indicator.

Second, the analysis shows that there is no clear, pre-established ranking of countries that would show which have the narrowest and which the widest gaps for the set of indicators considered. This means that the relative weight of the different gaps is unique to each country and that some will be very significant in one country but less so in another. In other words, there is no single "correct" classification of middle-income countries in the region; rather, there are as many classifications as there are criteria for identifying the principal obstacles to development in each case and thereby determining which of the specific gaps should be given the greatest consideration and weighting.

Because the importance of the gaps for different countries may differ according to priorities and objectives, there is a need for greater dialogue between donor and recipient countries, and recipients will have to play a proactive role in determining priority areas and ways of channelling ODA.

The following section presents the gap-based groupings of the middle-income countries of the region. The intent is to show that —beyond the specific statistical method used to generate the groups— the relative weighting given to each of the gaps determines the groupings to a large extent.

As a first approximation, three groups of countries were generated using only the human and physical capital gaps. As a second approximation, the groups were generated solely from the equality gap, then from the poverty gap and then from the fiscal gap. Finally, a classification using all the gaps considered here was generated.[10]

2. Methodology for generating gap-based country clusters

The methodology used to categorize and group countries was the so-called "clusters" technique (see box 2). This is a numerical technique that can classify a set of heterogeneous countries in a determined number of groups (clusters) using certain characteristics —in this case, the indicators used as proxies for the gaps. The technique is based on some type of measure of similarity or distance between the values for the indicators for each country, making it possible to identify which countries are most similar among themselves and in this way to construct clusters.

3. Results of the gap-based country classifications

Figure 5 presents the results of classifying countries into three groups on the basis of the following development gaps: human and physical capital gaps; equality gap; poverty gap; and fiscality gap. As the graph makes clear, the resulting clusters differ in accordance with the gaps that are prioritized in each case. For example, in the case that considers the human and physical capital gap (see figure 5A) there are two groups of nine countries each and one group of three countries, which includes Guyana, Jamaica and the Plurinational State of Bolivia. However, when the equality gap is considered (see figure 5B), the country groupings change. In this case there is one group of 12 countries, another of six countries and another three countries, which includes Colombia, Honduras and the Plurinational State of Bolivia. The same happens with the other classifications: country clusters change according to the specific gaps considered (see figures 5C, 5D and 5E).

[10] In this last classification, population size was included along with the gap indicators as an additional indicator for weighting countries' disparate dimensions. This weighting recognizes that the size of the economy (for various reasons amply documented in the literature) can have a major impact on development-related issues (see for example Escaith (2001) and Pérez-Caldentey (2005)).

Box 2
CLUSTER ANALYSIS

The cluster analysis is a technique that can classify a set of heterogeneous countries in a determined number of groups (clusters) using certain characteristics—in this case, the indicators used as proxies for the gaps. The technique is based on some type of measure of similarity or distance between the values for the indicators for each country, making it possible to identify which countries are most similar among themselves and in this way to construct clusters.

In the present case, the specific technique employed was a Ward's hierarchical cluster analysis, having previously standardized the variables analysed to correct for differences of scale.

Ward's method assumes that each element (here, each country) constitutes a cluster. In the second stage two elements are combined together in a cluster of size 2, and the other clusters are kept at size 1. This combination is made so that the sum of the distances, squared, of countries from the multifactorial centroid (the vector of the means of all the variables) of the cluster to which they belong is minimized.

The general formula for minimizing the Ward distance (W) is expressed as follows:

$$W = \sum_{g} \sum_{i \in g} (x_{ig} - \overline{x}_g)'(x_{ig} - \overline{x}_g)$$

Where x_q is the mean for group *g* and *i* is a country in that group.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of S. Tezanos Vázquez, "Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo", *Financiamiento del desarrollo* series, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2012, forthcoming.

These results clearly indicate the important role played by the development gap indicators that are being brought into such analyses: in the end, these indicators define the country clusters.

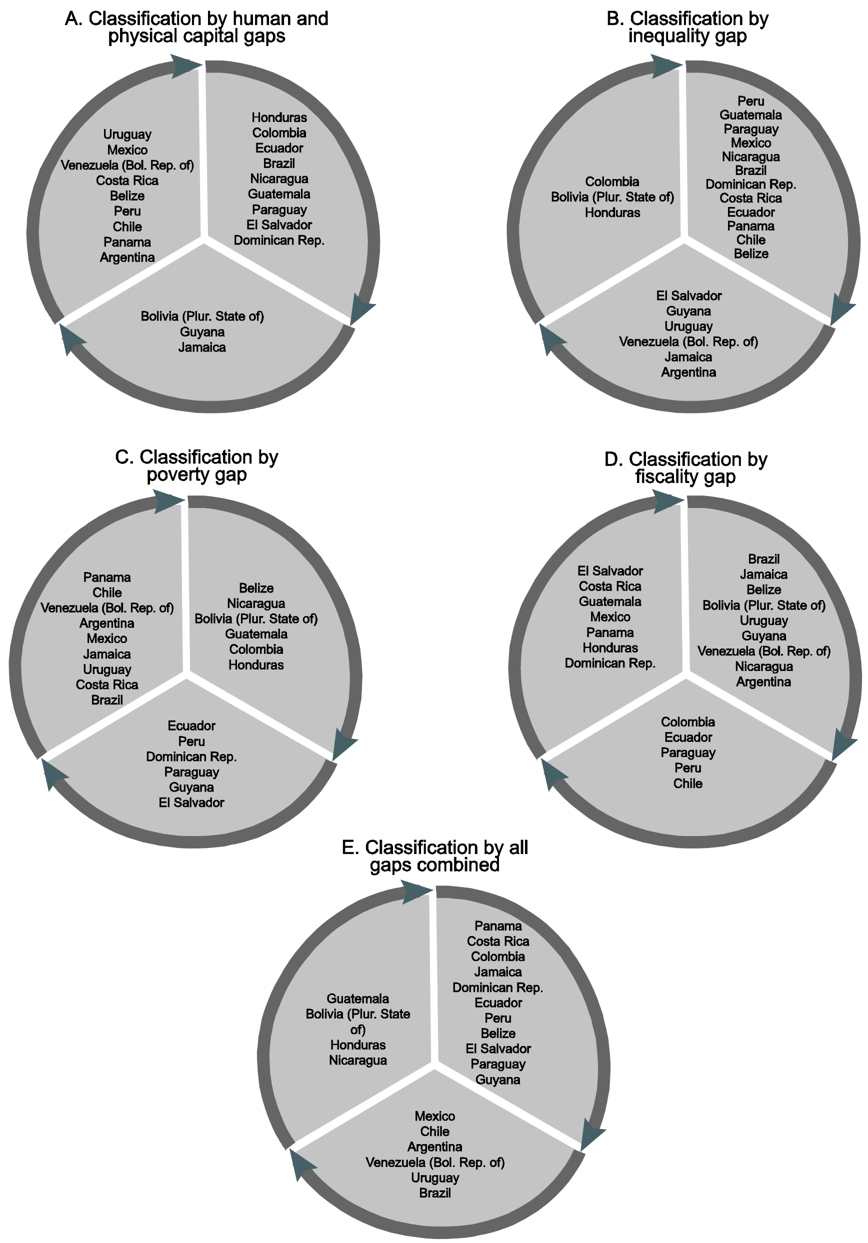
The classification that currently shapes the cooperation system rationale (using the income gap to define groups of countries) has an implicit weighting skewed heavily towards this gap. Consequently, an international cooperation system that considers that gap as the central element will not necessarily reflect the development challenges of a broad set of countries that may be performing relatively well in terms of income but that still have a long way to go in terms of development.

If the cooperation system is to provide a comprehensive response to the challenge of development, and if it is not to exclude countries classified as middle-income merely because they belong to that category, its focus will have to shift from per capita income to a broader and more comprehensive approach. This paper proposes a gap-based approach.

Because the importance and width of the gaps will differ among countries, the forums for dialogue between donor and recipient countries need to be strengthened, and recipients must play a proactive role in determining priority areas and ways of channelling cooperation flows. Existing national cooperation agencies, or offices responsible for cooperation issues, play an essential role as interlocutors with donors. Only through policy dialogue and consensus on a global agenda for development cooperation that incorporates the specific challenges that each country may identify will it be possible to achieve an international cooperation system that is truly inclusive and geared to development in the broad sense.

There could in fact be many forums for better targeting international cooperation with middle-income countries of the region; the structural development gap approach could be very useful for pinpointing the greatest vulnerabilities and challenges in each case.

Figure 5
GAP-BASED CLASSIFICATIONS OF MIDDLE-INCOME COUNTRIES



Source: Economic Commission for Latin America and the Caribbean (ECLAC) and S. Tezanos Vázquez, "Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo", *Financiamiento del desarrollo* series, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2012, forthcoming.

Nevertheless, this is only a first step. It will be essential to encourage forums for policy dialogue and for generating agreements between donor and recipient partner countries on the areas that are to be given priority and the forms of cooperation that will be adopted.

G. THE NEED FOR POLICY DIALOGUE AT DIFFERENT LEVELS

The gaps-based approach proposed by ECLAC reflects the variety and heterogeneity of development needs in Latin America and the Caribbean. It also stresses that there is no single hierarchy for those needs and that in fact the identification and ranking of priorities must rely on individual decisions by countries of the region.

Consequently, recipient countries must play an active role in establishing their development objectives. It is up to each country to identify the areas where development needs and challenges are greatest. This is a first key step toward ensuring that the international cooperation system can support all countries on the road to development. This more active role must be supported with the establishment of forums for policy dialogue and for building consensus and agreements at the different levels of the international cooperation system, so that cooperation flows will be channelled efficiently and will respond to countries' needs. The dialogue must take place at several levels.

First, there must be policy dialogue throughout the international community, one that will establish the general framework for discussing a global development agenda which, far from standardizing countries' development problems, will recognize their diversity and concrete specificities. The goal must be to generate a development agenda that includes the challenges facing all countries and that constitutes the basis on which the international cooperation system can organize its support.

Currently there are international forums where policy dialogue occupies an important place. However, these forums have been dominated by the Aid Effectiveness Programme, which has been gaining in importance over the years and which, as its name implies, has put aid effectiveness at the heart of the debate.[11]

Second, there needs to be a donor-recipient policy dialogue to examine in detail the challenges holding back development and on that basis to reach agreements on priority areas and forms of cooperation. This second level of dialogue is necessary so that donors take a broad view of development and will be able to work out with recipient partner countries the strategy best suited to each reality. From the viewpoint of recipient countries, a sound strategy would be for them to take the initiative in proposing the gaps they intend to prioritize and then prepare concrete policy proposals and ways in which international cooperation could provide support.

The second level of dialogue must combine the principle of ownership (meaning that recipient countries take the lead in establishing their own plans and policies for national development) with the principle of alignment (which calls upon donors to ensure that the support they provide based on the national development strategies of their recipient partner countries actually materializes through policy agreements to make these principles operational.

It is also important, as a third level of dialogue, to establish procedures for channelling cooperation between donors and recipients. For example, in countries where ODA represents a very low

[11] The Aid Effectiveness Programme had its origins in the mid-1990s with publication of a strategy paper by the Development Assistance Committee, *Shaping the 21st Century: the Contribution of Development Cooperation*, and it has been consolidated over the years in a series of international forums (Tezanos, 2010 Chapter VIII). The first High-Level Forum on Aid Effectiveness took place in 2002 in Rome, but it was in 2005, at the second High-Level Forum, that the issue was significantly moved forward with the Paris Declaration and the approval of five core principles that now constitute the central framework for the Aid Effectiveness Programme: ownership, alignment, mutual accountability, harmonization, and results-based management. Next came the third High-Level Forum in 2008, with the Accra Agenda for Action, and finally the fourth forum, held in Busan, Republic of Korea, in 2011.

percentage of GNP, it is natural that this should be channelled directly and targeted at specific problems, so as to avoid dispersal across too broad a spectrum of needs. On the other hand, in countries where ODA accounts for a larger percentage of income, cooperation can indeed support broader objectives within recipient countries' development agendas. In these cases, programme cooperation —which includes direct budget support among other mechanisms— makes more sense (see box 3).

Box 3

PROGRAMME AID IN LATIN AMERICA AND THE CARIBBEAN

Thinking about ways to enhance the impact and effectiveness of ODA has led to changes in its modalities and instruments. The project-aid approach has been questioned at times on the grounds that it tends to reflect the priorities of the donor rather than those of the recipient. Consequently, increasing emphasis is now being placed on programme aid (Sanahuja, 2008).

As White and Dijkstra (2003) describe it, the distinctive feature of programme aid is that the resources are not earmarked for financing specific development projects but are rather used to fund broader and more ambitious undertakings in partner countries. While there is a relatively wide range of programme aid modalities, the most important ones relate to food security, import support, external debt relief, budget support and the sector-wide approach (SWAp, which finances national policies in key sectors), as well as pools (or baskets of funding from multiple donors). Programme aid originally was conditioned on policy reforms that recipient countries were to implement in order to receive such funding (this was the case, for example, with the structural adjustment programmes of the IMF and World Bank). More recent approaches to programme aid, however, such as direct budget support and SWAps, rely on the principle of partnership between donor and recipient (a key feature of the Aid Effectiveness Programme), which involves replacing conditionality with co-responsibility.

Programme aid has generally been linked to poverty reduction strategy papers (PRSP). These appeared as part of the enhanced Highly Indebted Poor Countries Initiative (HIPC) of 1999. They are three-year plans spelling out, on one hand, the macroeconomic and social policies that countries will pursue to achieve the sustained growth needed to reduce poverty and, on the other hand, the principal sources of financing available in the country and its external funding needs. Developing countries themselves have, in principle, the lead in defining their PRSP, with participation from civil society and advice from the IMF, the World Bank and other donors. In recent years, many developing countries have prepared strategic poverty reduction plans as the basis for partnership, and donor countries are expected to align their aid with these plans. In Latin America and the Caribbean, nearly all countries have national development strategies, although in formal terms only seven countries have PRSPs associated with the enhanced HIPC initiative (Dominica, Grenada, Guyana, Haiti, Honduras, Nicaragua, and Plurinational State of Bolivia). Five of these countries are also participants in the Multilateral Debt Relief Initiative of the Inter-American Development Bank (Guyana, Haiti, Honduras, Nicaragua and Plurinational State of Bolivia) (see the summary of poverty reduction strategies of Latin American and Caribbean countries in annex 1, Tezanos (2010, pp. 251-250)).

Within the region, the use of programme official development assistance is fairly limited, accounting for only 6% of total commitments over the period 2003-2010. The share is much higher among the small States of the Caribbean, where this type of assistance amounts to just under one fifth of the total. Budget support has been the most common programme aid modality in most countries of the region other than the poorest Latin American countries, where such assistance has tended to take the form of emergency food aid.

An intrinsic characteristic of programme aid today is the deepening of the relationship of co-responsibility between donor and recipient (particularly in the case of budget support and SWAps), which is supposed to replace the old conditional aid programmes. Programme aid seeks to build on existing institutional capacities and structures in developing countries rather than generating redundant and inefficient parallel structures. One of the determinants of effectiveness for this type of aid is the institutional and governance capacity of aid recipients. The middle-income countries of Latin America and the Caribbean are good candidates for deepening this type of aid, in particular those countries that have the best governance indicators. This could be a win-win-win approach to cooperation in the region by reinforcing the ownership strategies of partner countries, lowering aid transaction costs (and thereby lessening aid fragmentation) and strengthening national systems of public administration.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of S. Tezanos Vázquez, "Conglomerados de desarrollo en América Latina y el Caribe: Una aplicación al análisis de la distribución de la ayuda oficial al desarrollo", *Financiamiento del desarrollo series*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2012, forthcoming.

Official development assistance earmarked for trade (aid for trade) is intended to reduce structural gaps and could therefore be very useful in countries of the region. Aid for trade seeks to boost the countries' own capacities so that they can draw greater advantage from available funds. It includes ODA targeted at various structural gaps identified in *Time for equality*: *closing gaps*, *opening trails* (ECLAC, 2010a), such as infrastructure and production capacity gaps. However, cooperation of this kind has is not yet gained much momentum in the region. Its potential should be further exploited, particularly in countries where these gaps are greatest (see box 4).

Box 4
AID FOR TRADE

The Aid for Trade Initiative is neither a new development fund nor a new ODA category. It simply provides recipient and donor countries with a framework for connecting a range of development assistance activities within a consistent strategy for trade development (OECD/WTO, 2009). The concept of aid for trade includes ODA earmarked primarily for (i) technical assistance for trade policy and regulations (for example, cooperating with countries in the development of trade strategies, negotiating trade agreements); (ii) trade-related infrastructure (for example, roads, ports and telecommunications networks to connect domestic markets to the global economy); (iii) production capacity-building (for example, helping the private sector exploit its comparative advantages and diversify its exports); (iv) aid for countries facing the costs of trade adjustment and integration (for example, the cost of tariff reductions); and (v) other trade-related needs (OECD/WTO, 2009).

Flows of aid-for-trade funding to all developing countries have been rising in recent years; in 2009 such commitments amounted to US$ 40 billion. However, Latin America and the Caribbean received only 8% of this total (OECD/WTO, 2011).

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

In general —and beyond the specific characteristics of recipient countries— an important element for channelling ODA efficiently is to have in place instruments for leveraging funds so as achieve a multiplication effect and take full advantage of the potential that cooperation holds.

This is especially true where the gaps selected as priorities require large volumes of financing. In Latin America and the Caribbean, a good example of infrastructure gap targeting is the Latin America Investment Facility (LAIF). This facility uses the limited funds contributed by the European Commission to attract sizable loans from the European Investment Bank, the Inter-American Development Bank and bilateral sources.[12] It therefore involves not only ODA but also cooperation in a broader sense: the initial funding provided by the European Commission is leveraged and ends up generating considerable volumes of financing that is channelled into physical and energy infrastructure projects, among others, of greater scope than could otherwise be attempted (Freres, Martínez and Angulo, 2010).

Along similar lines, another way in which development assistance can be made more fruitful is for traditional donors to support South-South cooperation efforts within the region. This is referred to as "triangular cooperation". There is significant room for South-South cooperation in specific areas where some countries have wide gaps and where other countries have developed the capacities to narrow them. Yet for such cooperation to materialize, the volume of financing required may be beyond the means of the countries of the region; hence the importance of support from traditional donors for cooperation of this kind.

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[12] The Latin America Investment Facility was launched in Madrid in May 2010 during the sixth Summit of Heads of State and Government of Latin America and the Caribbean and the European Union.

Innovative financing mechanisms can also be important forms of cooperation, and they can play a specific role in addressing many of the structural gaps in the countries of the region.

There is a wide variety of innovative financing mechanisms (for a detailed discussion, see ECLAC, 2011). One example can be found in Advance Market Commitments (AMCs), which could be useful for dealing with the health gap in some countries. They are designed to address the problem that pharmaceutical firms tend to shy away from research into diseases typical of lower-income countries because demand in those countries is more unpredictable and the risk of market non-viability is higher. An AMC establishes a partnership between donors and pharmaceutical companies whereby the companies commit to conducting the necessary research and to ensuring that once the medicines or vaccines are ready they are sold at an affordable price. Donors guarantee predictable and viable demand once the research is completed (ECLAC, 2011).

Another example of an innovative mechanism for closing the health gap is the Debt2Health initiative, which involves debt-for-health swaps. Under this initiative, launched in 2007 by the Global Fund to Fight AIDS, Tuberculosis and Malaria, creditors agree to forgive a portion of debt on the condition that the beneficiary country governments invest an agreed percentage in health programmes through the Global Fund. There are also innovative mechanisms involving debt-for-nature swaps that could be useful in countries with a significant environmental gap (see Titelman, Pérez-Caldentey and Vera, 2011).

Beyond these initiatives for addressing specific gaps, there are also innovative mechanisms with a more general purpose of financing development by mobilizing funds that are additional and supplementary to, and in no sense substitutes for, official development assistance.

Among these instruments, those that have attracted the most attention in recent times (in particular because of their revenue-generating potential) are global taxes, and, in particular, global taxes on financial transactions. ECLAC has repeatedly urged the international community to give serious consideration to the possibilities of applying some kind of globally coordinated financial transaction tax. The revenues that could flow to the region from such a levy are considerable, even if the tax rates were very low. Some estimates indicate that a global five-basis-point tax on all financial transactions would contribute some US$ 46.3 billion (or 1.2% of regional GDP) (see Schulmeister, 2010; Titelman and others, 2011).

It is clear, then, that a policy dialogue which includes identifying development priorities and the most glaring gaps is a crucial element of the approach presented here, as is a policy dialogue that includes identification of more appropriate and workable modalities for cooperation.

In the end, however sound the process of identifying needs and challenges, without policy dialogue the full potential of cooperation in its different forms and modalities is unlikely to be realized because failures of coordination could lead donors to address gaps that are not the most urgent ones for the recipient country.

II. CONCLUDING REMARKS

Since the 1960s Latin America and the Caribbean, like other middle-income regions, has seen a decline in its share of official development assistance flows. In fact, the ODA received by the region has trended sharply downwards, both in relative terms compared with other developing regions and in terms of the region's average gross national income (GNI). This trend sharpened in the 2000s with the approval of the development programme focused on the Millennium Development Goals.

The share of total ODA flowing to Latin America and the Caribbean amounted to 14% in the 1960s and currently stands at only 8%. As a portion of regional GNI, ODA targeting Latin America and the Caribbean dropped from more than 1% in the 1960s to 0.4% in the 1990s and 0.22% today.

This pattern reflects the international cooperation system rationale based on per capita income as the variable that reflects a country's level of development and therefore guides the allocation of official aid flows. As a result of this approach, it is the low-income and least developed countries that are receiving the bulk of flows (currently more than 65% of the total).

This paper argues for an alternative approach based not on per capita income but on a set of structural gaps (poverty, inequality, investment and savings, productivity and innovation, infrastructure, education and health, gender, the environment and fiscality) that are holding back sustained, equitable and inclusive growth in Latin America. These gaps constitute a point of departure for gauging needs and determining where the greatest challenges lie for the economies of the region, as the basis for an inclusive cooperation agenda.

An empirical analysis of country categories shows that they can be grouped differently depending on the specific gaps concerned in the study. The classifications presented in this paper on the basis of the equality gap do not yield the same cluster of countries as does the classification based on human and physical capital gaps or poverty gaps. The classification based on the income gap, which dominates the international cooperation rationale, generates a different cluster of countries ranked by per capita income.

This analysis confirms one of the central hypotheses of the paper, namely that there is no single, uniform and objective classification for all countries. Thus, a classification of countries based solely on their income gap provides only a very partial reflection of their development constraints.

An inclusive view of development demands consideration of all the gaps that countries face. It requires that countries establish their own development priorities and weigh their gaps. In each country's context, the relative weight of each gap will be different, as some will be very important in one country but less so in others.

This means not only that countries must take the initiative in determining their own development needs but also that they must promote and participate in policy dialogue at various levels in order to give priority to those areas and modalities of cooperation best suited to their needs.

On one hand, there is the need for a broad policy dialogue that will engage the international community in discussing a global development agenda that embraces the wide range of needs and specific circumstances at a country level and that will guide the actions of the international cooperation system. At the present time the international forums in which policy dialogues are conducted are too heavily focused on effectiveness as the core issue of discussion.

On the other hand, this global dialogue must provide a framework for discussion between donors and recipients that can identify and prioritize development gaps and yield proposals for international cooperation policies and modalities.

In the particular case of Latin America, this means improving the existing modalities of cooperation so as to address some of the social gaps that now attract the bulk of official aid flowing to the region. The goal is to open new spaces for cooperation and to consolidate new modalities such as programme aid, triangular cooperation and aid for trade.

The alternative approach seeks above all to bring the middle-income countries back into the international cooperation system. Given their growing economic and social weight (they account for more than 70% of the world population and more than 70% of the world’s poor), including and supporting middle-income countries is of systemic importance in several key areas, such as world economic growth, economic and financial stability, environmental protection and social well-being.

The gaps-based approach in no way downplays the importance of achieving the corresponding Millennium Development Goal. Rather, it places the Millennium Development Goals in the broader context of the obstacles that the development process entails and that differ according to each country’s capacities, needs and specific characteristics.

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