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Meeting in the Middle?

Challenges and opportunities for EU cooperation with Middle-Income Countries

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About this paper

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Acronyms

ACP	African Caribbean Pacific Group of Countries
ADE	Aide a la Decision Economique
BRICS	Brazil, Russia, India, China, South Africa
CBDR	Common But Differentiated Responsibilities and respective capabilities
CFSP	Common Foreign and Security Policy
CODEV	Council Working Party on Development Cooperation
CPA	Cotonou Partnership Agreement
CPIA	Country Policy and Institutional Assessment
CSDP	Common Security and Defence Policy
CSO	Civil Society Organisation
DAC	Development Assistance Committee of the OECD
DCFTA	Deep and Comprehensive Free Trade Areas
DCI	Development Cooperation Instrument
DIIS	Danish Institute for International Studies
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECDPM	European Centre for Development Policy Management
EDF	European Development Fund
EEAS	European External Action Service
EIB	European Investment Bank
ENI	European Neighbourhood Instrument
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood and Partnership Instrument
EPI	Environmental Protection Index
ERD	European Report on Development
ERDF	European Regional Development Fund
ESDP	European Security and Defence Policy
ESF	European Social Fund
EU	European Union
EUSR	European Union Special Representative
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNI	Gross National Income
GSP	Generalized Scheme of Preferences
HIC	High-Income Country
IBSA	India, Brazil, South Africa
IDA	International Development Association (World Bank)
IfS	Instrument for Stability
IPA	Instrument for Pre-Accession Assistance
IMF	International Monetary Fund
JAES	Joint Africa EU Strategy
LDC	Least Developed Country
LIC	Low-Income Country
LIFE	Programme for the Environment and Climate Action
LMIC	Lower Middle Income Country
MDG	Millennium Development Goals

MIC	Middle-Income Country
MIFF	Middle-Income but Failed or Fragile state
NGO	Non Governmental Organization
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PICNI	Pakistan, India, China, Nigeria and Indonesia
PPP	Public Private Partnership
SADC	South African Development Community
SADPA	South African Development Partnership Agency
SIDS	Small Island Developing States
SME	Small and Medium Enterprises
TAIEX	Technical Assistance and Information Exchange Instrument
TDCA	Trade, Development and Cooperation Agreement
UMIC	Upper Middle Income Country
UN	United Nations
UNOPS	United Nations Office for Project Services
UNDESA	United Nations Department for Economic and Social Affairs
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
UNFPA	United Nations Populations Fund
UNICEF	United Nations Children’s Fund
UNOPS	United Nations Office for Project Services
WGI	World Governance Indicators

Executive Summary

Framing the discussion on EU cooperation with Middle-Income Countries

1. This paper presents a contribution to the on-going policy debate on how the European Union (EU) can best engage with Middle Income Countries (MICs). There is a growing perception that MICs can or should be able to finance development efforts for poverty reduction themselves. However, the discussion goes beyond that in exploring the challenge of adapting the policy and practice of European development cooperation in a changing world.

2. The discussion requires the EU as well as its Member States to look beyond traditional perceptions of 'developed' and 'developing' countries. This binary distinction is most commonly made on the basis of levels of national income, growth and production, which nowadays still frequently motivate policy decisions in several areas (e.g. trade and development cooperation). Nonetheless, there is increasing appreciation of the fact that such classifications are losing relevance as global patterns of poverty and the balance of economic and political power have shifted.

3. Notably, three quarters of the world's poor (earning less than US$ 1.25 a day per capita) currently reside in eight middle-income countries: China, India, Russia, Nigeria, Indonesia, Pakistan, Mexico and Brazil. These 'big 8' countries have experienced sustained (or on-going) periods of above-average income growth, have large numbers of inhabitants (> 100 million each) and contain significant natural resource endowments and therefore benefit from scale effects. Not only do these countries represent large markets but they have begun to develop significant productive capacity. In addition, these countries increasingly assert political influence in regional and international fora.

4. Whereas the EU is very aware of the fact that the MICs in general, and the 'big 8' in particular, represent a significant strategic interest for the European Member States (in terms of trade, natural resources and political influence as well as in providing a range of global public goods) the partnerships with and tools applied to these countries are still being adapted to this thinking.

5. In this regard, Official Development Assistance (ODA) is losing relevance in comparison to other financial flows and revenues – many MICs have little to no dependence on ODA. This is not to say that ODA can no longer add value to the EU's engagement with MICs – on the contrary, the MICs offer the opportunity to explore and pilot new methods to specifically target and deliver ODA to catalyse other financial flows and efforts towards development objectives.

Key issues and characteristics of MICs

6. An early observation is that the MICs category comprises countries which are far more diverse than aggregate figures illustrate. Reviewing the literature reveals several key issues prevalent among MICs that link to persisting patterns of poverty, namely:

   - State fragility, particularly in lower-middle income countries (LMICS), which puts large numbers of people at risk of sliding into poverty;

   - The 'middle-income trap', primarily caused by slow or unsuccessful economic transformation, further fuelled by trade dependence, slow export expansion and commodity-driven growth;

- Income inequality, due to unequally distributed gains from growth and the absence of (effective) redistributive policies and programmes;

- Environmental and economic vulnerability caused by industrialisation processes and the geographic attributes of specific MICs.

7. While the individual issues may not be unique to MICs, their configuration poses unique challenges for external actors, and should therefore be considered when determining the nature and degree of engagement with the MICs, particularly give the waning relevance of ODA.

8. Although there are important variations among MICs, there are to a certain degree typified as having more capacities or better opportunities for reducing poverty when compared to the low-income countries (LICs). Furthermore, the potential for generating domestic resources renders the cost to donors for reducing poverty in the MICs much lower, offering a compelling reason for exploring partnership objectives beyond poverty reduction.

9. Engagement with the MICs is warranted in light of the above, but would need to be managed and shaped differently from the typical development cooperation-driven contexts, reassessing also the tools used. Realising this diversification of cooperation will require, in the first instance, clarifying how areas of engagement beyond traditional development cooperation link to poverty reduction in MICs, as well as what other shared objectives and priorities can form the basis of any potential partnership.

Scope for continued engagement with MICs in development cooperation and beyond

10. The EU's engagement with the MICs, particularly those outside its immediate neighbourhood, has traditionally been framed by its principles and objectives of development cooperation, in which the primary stated interest is poverty reduction and, ultimately, eradication. Whereas the EU's current development cooperation framework proposes to target cooperation efforts and resources towards those countries 'most in need', MICs are not overlooked: the EU's development policy statements make reference to both the issues faced by the MICs noted above as well as the MICs' strategic importance in regional and multilateral fora.

11. Importantly, the EU's current development cooperation framework acknowledges the special nature of the MICs, and proposes to actively seek new instruments and partnerships for cooperation going forward. The EU further recognizes the MICs' crucial contribution to the provision of global public goods. This could serve to justify using European ODA in specific countries (for instance the 'big 8') to 'catalyse' or ensure the sustainability of the results achieved in neighbouring LICs and MICs. The proposed instruments for EU development cooperation for the period 2014-2020 are applicable to the majority of MICs, and target several of the key issues they are faced with.

12. Whereas the EU has built up significant competence to provide effective external support to MICs through development cooperation, the EU's engagement with the MICs does not begin or end at development cooperation. Indeed, the EU engages with MICs and other countries in a wide number of policy areas, including trade, cohesion, enlargement, neighbourhood, foreign and security policy as well as in international negotiations. Section 3 provides an overview of the differentiation of the MICs in these various frameworks. These policies and the instruments employed are driven by multiple interests beyond poverty reduction, and therefore have new or notably different implications for the EU's partnership with the MICs.

13. This multiplicity of policy commitments towards or affecting the MICs is both a benefit and a concern for future cooperation. On the one hand, the EU can employ a diverse array of instruments at different times and for different purposes. There are thus a large number of imaginable configurations of instruments with which to engage with MICs, which ensures that the EU will most likely be able to identify and form partnerships with MICs on the basis of diverse sets of mutual interests.

14. On the other hand, the various commitments and the instruments attached to them operate at different 'speeds': they are driven by different interests and priorities, and their underlying policy frameworks furthermore do not affect all MICs equally, so some 'picking and choosing' is required. For those concerned with poverty, there is also the added concern that these instruments may not always have a positive developmental impact.

15. The EU will therefore have to invest in exploring its wealth of policy frameworks and instruments in order to identify lessons and best practices to inform the negotiation and design of partnerships and instruments for cooperation with the MICs. Section 5 and Annex III explore what (non-)ODA instruments, modalities and budgets the EU has available, and to what extent the EU can sufficiently and effectively make use of its full palette of external actions when seeking to engage with the MICs.

Conclusions and recommendations for further policy discussion

16. In conclusion, it will first of all be necessary to further clarify the purpose, nature and scope of the EU's engagement with MICs beyond traditional development cooperation. For this to form the basis for effective cooperation going forward, the EU will need a clear understanding also of what the respective MICs look to the EU for. Given that the European project goes far beyond the promotion of economic growth, the EU should have a natural interest in further investing in developing alternative ways to differentiate between its partner countries. More politically infused analysis of the needs, resources and policies of the MICs, with the search for shared interests at its centre, would benefit the clarity and specificity of policy frameworks and instruments employed and consequently increase the chances of effective partnership.

17. Second, the EU should employ such political economy analysis to better differentiate between the MICs, and adopt more tailor-made and effective approaches for cooperation with individual MICs. This is particularly relevant in finding new ways for ODA to operate in conjunction with deepening economic and political engagement with MICs. Specific modalities need to be identified to target ODA resources in order to incentivize and catalyse change in clearly identified issues affecting the attainment of development objectives.

18. Third, the EU and its Member States must draw more systematically on the EU's own track record of cooperation with MICs under various policy frameworks and using different (non-ODA) instruments in order to integrate lessons learnt. The EU's cooperation with the MICs should be informed by its comparative advantages, e.g. its broad and deep toolbox of instruments and the potential for learning and increasing impact that this affords to new partnerships.

1. Introduction

This paper presents a contribution to the on-going policy debate on how the European Union (EU) can best engage in promoting poverty reduction in Middle Income Countries (MICs). As part of his agenda for reforming European development cooperation, Development Commissioner Andris Piebalgs described the essence of this policy challenge as follows on his blog: *"I am aware that poverty pockets exist in middle-income countries and will continue to cooperate with these countries on many urgent issues such as fight against HIV/AIDS. But in reality, EU aid levels are not high in comparison with the budget of these countries and can have higher impact in least developed countries"* (Piebalgs 2011).

Although few would consider European development cooperation well-spent in fast-growing economies like China and Brazil, the EU Treaty does not 'earmark' its development budget to the poorest countries but only states that it should be used with a primary objective of reducing poverty. Implicitly Commissioner Piebalgs also refers to a general challenge as to how EU development cooperation should be reshaped in view of the reducing absolute and relative influence of European Official Development Assistance (ODA) in developing countries (Vanheukelom et al 2012). The Commissioner sought to draw a line by arguing that *"(…) some countries can now afford to fight poverty themselves"*, but the question of whether or not EU development funding should go to MICs is part of a broader challenge of how to adapt the policy and practice of European development cooperation in a changing world (Piebalgs 2011).

This challenge requires that the EU as well as its Member States look beyond traditional perceptions in the development discourse, notably the dichotomy between 'developed' and 'developing' countries. Whereas the EU is very aware of the fact that the MICs represent a significant strategic interest for the European Member States (in terms of trade, addressing security threats, natural resources and political influence as well as in providing a range of global public goods[1]) the partnerships with and tools applied to these countries are still being adapted to this thinking.

A wider array of foreign policy issues and instruments is required, beyond development cooperation as we know it today, and which hold the promise of establishing new forms of partnership with the MICs. In response, the EU's cooperation with several MICs already extends beyond the objective of poverty reduction, for instance the EU's engagement with China, India, Thailand, the Philippines and South Africa. This is also clearly evident in the EU's cooperation with the MICs in its own neighbourhood, and useful lessons can be drawn for MICs with which the EU seeks to move away from a donor-recipient relation. A critical question in this regard is not only what the EU's interest in the MICs is, but what the MICs expect from the EU.

This Discussion Paper will first explore how the practice of dividing nation states into groupings as a tool for targeting policies originated and evolved (Section 2), including the category of Middle Income Countries. The section concludes with a short analysis of how recent global developments, particularly involving the MICs, have made the present policy discussion all the more urgent. Section 3 provides an overview of the distinctive characteristics and issues facing the MICs and what they imply for the relevance of Official Development Assistance (ODA) in cooperation with these countries. Section 4 examines the existing commitments and objectives for cooperation with the MICs as expressed in EU development policy

[1] A global public good is a good that has the three following properties: (1) it is non-rivalrous, i.e. use of this good by anyone does not reduce the quantity available to other agents; (2) it is non-excludable, i.e. it is impossible to prevent anyone from consuming that good and (3) it is available worldwide. See Koch 2012 for a more detailed discussion on definitions used.

documents, pointing out the opportunities and challenges in the context of its evolving external action policies.

Subsequently, Section 5 analyses several of the EU's instruments, modalities and budget lines for engaging with the MICs beyond development cooperation. Section 6 provides deeper insight into new forms of cooperation by exploring the EU's engagement with South Africa. Finally, Section 7 concludes by deriving conclusions from how the EU has adapted these instruments to the specificities of the countries targeted by its external action policies and instruments. Key recommendations are presented to inform the Danish and other EU Member States' positions towards the EU's policy and practice for cooperation with the MICs.

2. The origin and evolution of the Middle Income Countries category

2.1. The practice of classifying countries

The practice of classifying countries into different groupings as a means to guide decision-making is commonly held to originate from the 1950s. The best known of these classifications is that of 'developed' and 'developing' countries, originally the distinction between First, Second and Third 'worlds', and the policy jargon distinguishing aid 'donors' and 'recipients' (Harris, Moore and Schmitz 2009). For a considerable period of time, such classifications have proved convenient for political and diplomatic engagements by reinforcing the political, developmental and security perspectives and concerns of the dominant narrative at the time.

While these dichotomies seem strong, they are not well defined: there is no established convention for the designation of 'developed' or 'developing' countries. Through the process of classifying countries along this dichotomy, national income, growth and production levels have been established as central to the definition and differentiation of levels of 'development'[2] (King et al 2012). Income and growth levels nowadays still frequently motivate policy decisions, both for development cooperation and other areas of external action.

Many caveats exist to such classifications, owing in part to the arbitrary nature of classification itself. As a result, there is today an increasing appreciation of the fact that the binary developed-developing distinction and classifications have been losing relevance since the mid-1970s particularly as a broader conception of 'development' has emerged and the global balance of economic and political power has shifted.

The adoption of the Millennium Development Goals (MDGs)-framework in 2000 marks a broad consensus on a definition of 'development' beyond national income. Large numbers of new indices, rankings and classifications have since been put forward as rival benchmarks to influence public policy and development practice (Harris, Moore and Schmitz 2009). Income-based classifications remain in use, leading to anomalies such as the fact that some developing country governments nowadays get commercial loans at better rates than some developed ones. The changing global economic landscape furthermore means that certain countries are simultaneously classified as 'emerging economic superpowers' and 'developing countries'.

[2] As per this understanding, social conditions and political systems in countries were taken to be symptoms of economic underdevelopment. Notably, the UN Secretariat convened an expert group which prepared a 'Report on International Definition and Measurement of Standards of Living', distinguishing between 'standards', 'norms' and 'levels' of living, covering a broad range of indicators on all aspects of daily life. See: United Nations (1961)

2.2. The Middle-Income Countries category

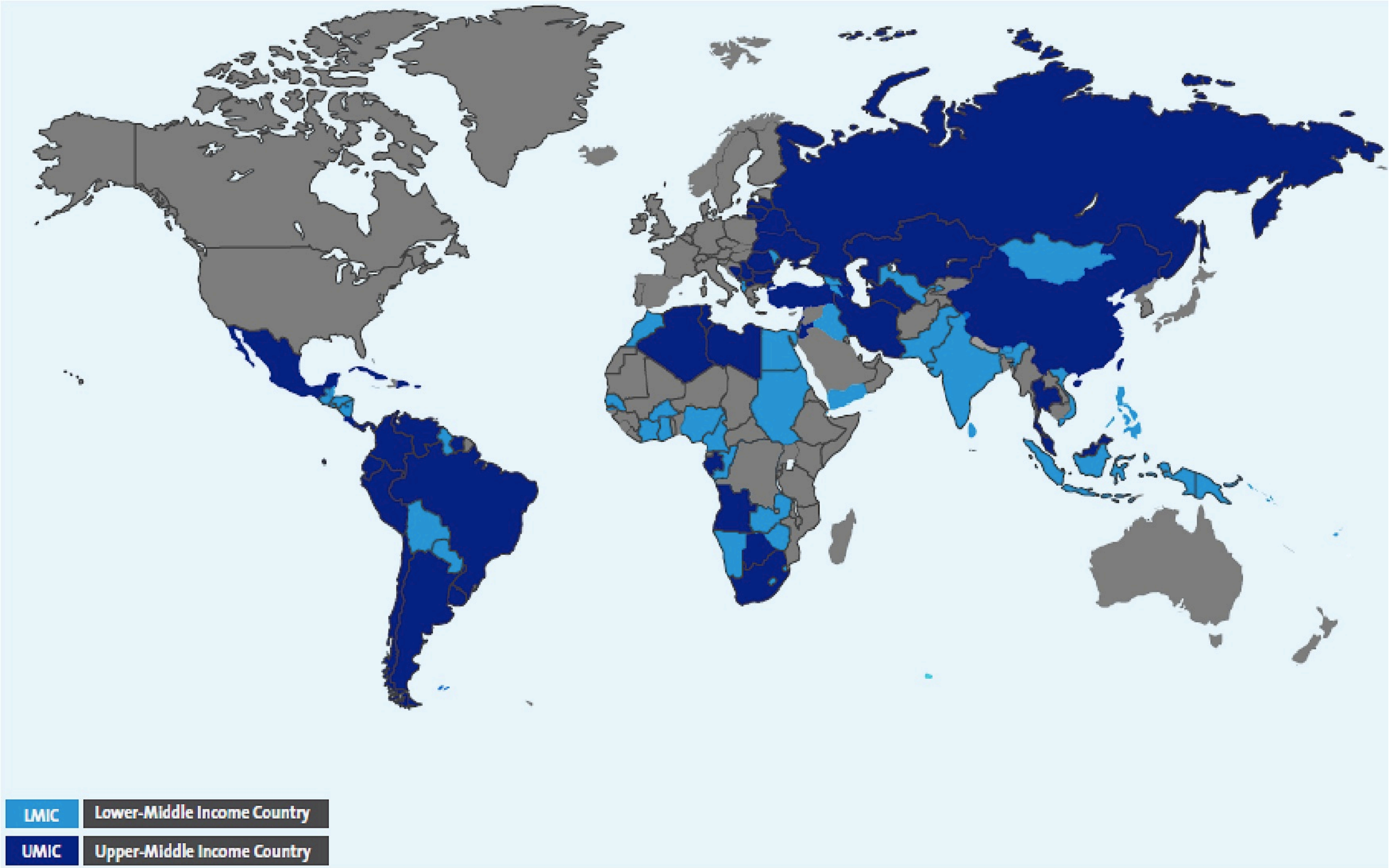
Discussion on how to best differentiate between (groups of) countries has gained prominence in the discourse on development cooperation and other foreign policy instruments among international actors.[3] A particularly contentious issue of the income-based classifications concerns the category of Middle-Income Countries (or MICs). Situated between the Low-Income Countries (LICs) and High-Income Countries (HICs), the MICs are credited with achieving high levels of economic growth and gains in poverty reduction.

The MICs are grouped according to the criteria of annual gross national income (GNI) per capita, as part of a global classification. Two dominant classification systems are maintained by the OECD and the World Bank (WB)[4], and both split the MICs group into two sub-groups: lower-middle income countries (LMICs) and upper-middle income countries (UMICs). According to the OECD DAC List of ODA recipients, there are 40 LMICs (at a GNI between US$ 1,006 and 3,975 per capita per year at 2010 prices) who are not LDCs and 54 UMICs (at US$ 3,976 to 12,275 per capita), whereas the World Bank Country and Lending Groups lists 54 countries as LMICs (at a GNI of US$ 1,026 to 4,035 per capita at 2011 prices) and also 54 countries as UMICs (US$ 4,036 to 12,475 per capita). See Annex I for a full overview of the countries covered by both classification methods as well as a more detailed explanation of the difference between the two, and Figures 1 for a snapshot of the MICs worldwide.[5]

Since the World Bank instituted the LMIC and UMIC categories in 1987, the number of MICs has increased from 77 to 108 – a significant increase even if one takes into account the 34 new countries that have come into existence since the 1990s.[6] This is principally due to the fact that various LICs have ‘graduated’ into the MICs category. The number of LICs has decreased from 48 to 36 since 1987, accompanied by a decrease of the number of poor worldwide by over 450 million people.[7] It is widely recognised that this rise in income levels has brought with it, on average, a rise in living standards for large numbers of people in the MICs and former LICs. This is not to say, however, that the MICs category determines countries ‘in transition’ towards HICs[8], and that therefore issues affecting them are transitory. Indeed, while part of countries entering the MICs category are newly-formed states as a result of the collapse of the Soviet Union, there have also been countries falling back from the HICs to the MICs category – including recently some European Member States.[9]

[3] For an analysis of recent policy discussions on differentiation in the EU, please refer to Keijzer et al (2012).
[4] See http://www.oecd.org/dac/aidstatistics/daclistofodarecipients.htm and http://data.worldbank.org/about/country-classifications/country-and-lending-groups.
[5] For the purpose of this study, the World Bank list is used. This is motivated by the fact that the World Bank classification is applied to wide variety of data on countries worldwide (rather than only ODA).
[6] Rosenberg (2012)
[7] Measured in the number of persons living below $1.25 a day poverty line at 2005 PPP. See World Bank PovcalNet - http://iresearch.worldbank.org/PovcalNet/index.htm
[8] See footnote 2.
[9] See also Koch (2012)

Figure 1. Map and listing of MIC's worldwide according to the World Bank Country and Lending Groups classification



LMIC = annual per capita GNI of US$ 1,026 to 4,035

UMIC = annual per capita GNI of US$ 4,036 to 12,475

Income group	Country	Region	LDCs	Fragile
LMIC	Albania	ECA		
UMIC	Algeria	MENA		
UMIC	American Samoa	EAP		
UMIC	Angola	SSA	✔	✔
UMIC	Antigua and Barbuda	LAC		
UMIC	Argentina	LAC		
LMIC	Armenia	ECA		
UMIC	Azerbaijan	ECA		
UMIC	Belarus	ECA		
LMIC	Belize	LAC		
LMIC	Bhutan	SA	✔	
LMIC	Bolivia	LAC		
UMIC	Bosnia and Herzegovina	ECA		✔
UMIC	Botswana	SSA		
UMIC	Brazil	LAC		
UMIC	Bulgaria	ECA		
LMIC	Cameroon	SSA		
LMIC	Cape Verde	SSA		
UMIC	Chile	LAC		
UMIC	China	EAP		
UMIC	Colombia	LAC		
LMIC	Congo, Rep.	SSA		✔
UMIC	Costa Rica	LAC		
LMIC	Côte d'Ivoire	SSA		✔
UMIC	Cuba	LAC		
LMIC	Djibouti	MENA	✔	
UMIC	Dominica	LAC		
UMIC	Domincan Republic	LAC		
UMIC	Ecuador	LAC		
LMIC	Egypt, Arab Rep.	MENA		
LMIC	El Salvador	LAC		
LMIC	Fiji	EAP		
UMIC	Gabon	SSA		
LMIC	Georgia	ECA		
LMIC	Ghana	SSA		
UMIC	Grenada	LAC		
LMIC	Guatemala	LAC		
LMIC	Guyana	LAC		
LMIC	Honduras	LAC		
LMIC	India	SA		
LMIC	Indonesia	EAP		
UMIC	Iran, Islamic Rep.	MENA		
LMIC	Iraq	MENA		✔
UMIC	Jamaica	LAC		
UMIC	Jordan	MENA		
UMIC	Kazakhstan	ECA		
LMIC	Kiribati	EAP	✔	✔
LMIC	Kosovo	ECA		✔
LMIC	Lao PDR	EAP	✔	
UMIC	Latvia	ECA		
UMIC	Lebanon	MENA		
LMIC	Lesotho	SSA	✔	
UMIC	Libya	MENA		✔
UMIC	Lithuania	ECA		
UMIC	Macedonia, FYR	ECA		
UMIC	Malaysia	EAP		
UMIC	Maldives	SA		
LMIC	Marshall Islands	EAP		✔
UMIC	Mauritius	SSA		
UMIC	Mexico	LAC		
LMIC	Micronesia, Fed. Sts.	EAP		✔
LMIC	Moldova	ECA		
LMIC	Mongolia	EAP		
UMIC	Montenegro	ECA		
LMIC	Morocco	MENA		
UMIC	Namibia	SSA		
LMIC	Nicargua	LAC		
LMIC	Nigeria	SSA		
LMIC	Pakistan	SA		
UMIC	Palau	EAP		
UMIC	Panama	LAC		
LMIC	Papua New Guinea	EAP		
LMIC	Paraguay	LAC		
UMIC	Peru	LAC		
LMIC	Philippines	EAP		
UMIC	Romania	ECA		
UMIC	Russian Federation	ECA		
LMIC	Samoa	EAP	✔	
LMIC	São Tomé and Principe	SSA	✔	
LMIC	Senegal	SSA	✔	
UMIC	Serbia	ECA		
UMIC	Seychelles	SSA		
LMIC	Soloman Islands	EAP	✔	✔
UMIC	South Africa	SSA		
LMIC	South Sudan	SSA		✔
LMIC	Sri Lanka	SA		
UMIC	St. Lucia	LAC		
UMIC	St. Vincent and the Grenadines	LAC		
LMIC	Sudan	SSA	✔	✔
UMIC	Suriname	LAC		
LMIC	Swaziland	SSA		
LMIC	Syrian Arab Republic	MENA		
UMIC	Thailand	EAP		
LMIC	Timor-Leste	EAP	✔	✔
LMIC	Tonga	EAP		
UMIC	Tunisia	MENA		
UMIC	Turkey	ECA		
UMIC	Turkmenistan	ECA		
UMIC	Tuvalu	EAP	✔	✔
LMIC	Ukraine	ECA		
UMIC	Uruguay	LAC		
LMIC	Uzbekistan	ECA		
LMIC	Vanuatu	EAP	✔	
UMIC	Venezuela, RB	LAC		
LMIC	Vietnam	EAP		
LMIC	West Bank and Gaza	MENA		
LMIC	Yemen, Rep.	MENA	✔	✔
LMIC	Zambia	SSA	✔	

Acronym	Full legend name
LMIC	Lower-Middle Income Country
UMIC	Upper-Middle Income Country
ECA	Eastern Europe and Central Asia
MENA	Middle East and North Africa
EAP	East Asia and the Pacific
SSA	Sub-Saharan Africa
LAC	Latin America and the Caribbean
SA	South Asia
LDC	Least Developed Country
Fragile States	Fragile or Conflict Affected Situations

Countries are classified into lower- and upper-middle income countries according to the World Bank Country and Lending Groups list of July 2012. Countries with a 2011 GNI per capita of $1,026 - $4,035 are defined as LMICs, those of $4,036 - $12,475 as UMICs. The same list is used to group countries into regions.

Least Developed Countries (LDCs) are classified according to the UN-OHRLLS list. Fragile or Conflict-Affected Situations are classified according to the World Bank's Harmonised List of Fragile Situations for the financial year 2013.

Meanwhile, the EU has evolved its own approach to classification – usually grouping countries according specific policy frameworks (some with a legal basis, some as looser commitments) with associated goals. The MICs category cuts across various regional and global groupings which the EU uses, as demonstrated in Table 1. However, only in the EU's development and trade policies is the MICs category explicitly used and referred to (as will be explored in section 4) – in other policy areas partnerships are formed on the basis of more explicit political, geo-strategic analysis.[10]

Table 1: Overview of EU policy frameworks, instruments and MIC's included

EU Policy Framework	Goals	Instrument(s)	MIC included
Cotonou Partnership Agreement (CPA)	- Poverty reduction and eradication; - Promote sustainable development; - Integrate African, Caribbean and Pacific countries into the world economy.	European Development Fund (EDF), political dialogue	All MICs in Sub-Saharan Africa, Caribbean and Pacific
European Neighbourhood Policy (ENP) (including EuroMed)	- Support progress towards 'deep democracy'; - Support sustainable economic and social development; - Build effective regional partnerships.	European Neighbourhood and (Partnership) Instrument (ENI, ENPI), political dialogue	Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, the Republic of Moldova, Morocco, the Occupied Palestinian Territories, Syria, Tunisia and Ukraine
Enlargement and Cohesion policy	Unite and strengthen the European continent socially, economically and politically.	Instrument for Pre-Accession Assistance (IPA), TAIEX, Twinning, political dialogue	Albania, Bosnia and Herzegovina, Bulgaria, Macedonia, Kosovo, Latvia, Lithuania, Montenegro, Serbia, Romania, Turkey
Joint Africa-EU Strategy	- Improve Africa-EU political relations - Promote effective multilateralism - Promote peace, security, democratic governance, human rights, basic freedoms, gender equality, sustainable economic development, regional and continental integration - Promote the attainment of the MDGs.	Political and policy dialogue & a future proposed Pan African Envelope in the DCI	All MICs in Africa

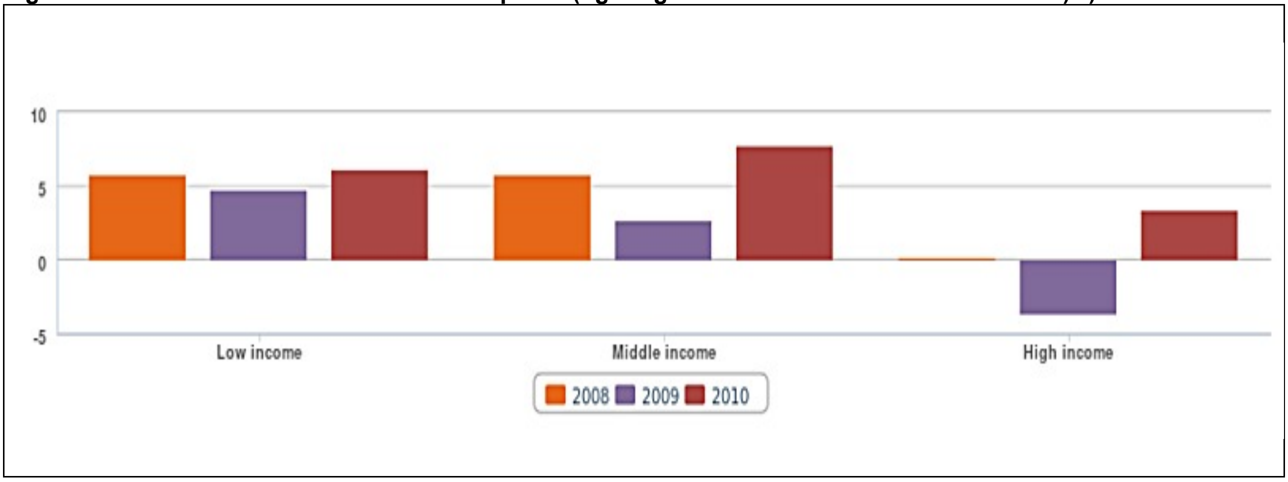
[10] Interestingly, different EU Member States and services within the EU institutions do not adhere to the same country classifications. For example, the Directorate-General for Development and Cooperation – Europeaid (DG DEVCO) uses the OECD DAC list in determining aid allocations, whereas the Directorate-General for Trade (DG TRADE) adheres to the World Bank list to determine eligibility for trade preference schemes. This suggests that such classifications are predominantly a matter of practical convenience rather than precision.

2.3. Notable trends affecting the MICs category[11]

Given that MICs comprise approximately half the countries of the world, and can be found on each continent, it can be presumed that the MICs category comprises a grouping of countries which is far more diverse than aggregate figures will reveal. Sixteen of the MICs are also Least Developed Countries (LDC)[12], and the incidence of poverty in the MICs ranges from 2% of the population to over 60% (UNDP, UNFPA and UNOPS 2011). Notably for the EU, all of the EU neighbourhood countries are MICs.

Aside from the obvious shared feature of higher levels of income, both in absolute and per capita terms, the MICs share a few more common characteristics (each with a few notable exceptions) that are said to set them apart as a group. First, MICs have had consistently higher levels of GDP growth compared to the group of Higher Income Countries, as shown in Figure 2.

Figure 2: Recent levels of GDP Growth compared (figure generated from World Bank website)[13])



In general, MICs have advanced along the 'demographic transition curve'[14], thereby currently displaying lower fertility and population growth rates than the world median. Noteworthy exceptions to this are low or even negative population growth in Eastern European and Central Asian MICs and above-average growth rates in MICs found in the Eastern Pacific, the Middle East and Eastern Africa.

The MICs furthermore follow the worldwide urbanisation trend: 65% of the population in UMICs on average live in urban areas, whereas this amounts to 45% for the LMICs. Small island states in the Pacific and the Caribbean, along with certain large countries in South and South-East Asia (Laos, India, Pakistan, Thailand and Vietnam) have significantly below-average rates of urbanisation, though the MICs all display population growth rates in urban areas above the national average (over 2% versus between 1 – 1.5% respectively, for LMICs and UMICs).

The MICs are also home to a burgeoning 'middle class'. While definitions of the middle class can vary greatly, the commonly used OECD and African Development Bank definition denotes the population earning between US$ 2 and 20 per day, which make up roughly 45% of the population for MICs

[11] Data noted in sections 2 and 3 are the most recent figures derived from the World Bank, retrieved from http://data.worldbank.org/ in November 2012.
[12] Namely: Angola, Bhutan, Djibouti, Kiribati, Laos, Lesotho, Samoa, Sao Tome and Principe, Senegal, the Solomon Islands, Sudan, Timor-Leste, Tuvalu, Vanuatu, Yemen and Zambia.
[13] See http://databank.worldbank.org/Data/Views/Reports/Chart.aspx
[14] The term 'demographic transition' refers to the transition from high birth and death rates to low birth and death rates as a country develops from a pre-industrial to an industrialized economic system.

(Carbonnier and Sumner, 2012). The middle classes are expected to grow rapidly, particularly in the Asian and Pacific countries (notably India and China), and contribute considerably to the further economic growth of these countries through consumption expenditure and tax revenues. This is significant, as domestic tax returns are said to provide for a more sustainable form of long-run growth than that driven by exports alone (Kharas 2010).

Recent policy debates on development cooperation and foreign policy towards MICs have taken place against the backdrop of the widely acknowledged fact that the majority of the world's poor people live in middle-income countries. Among the MICs, and indeed worldwide, poverty is concentrated in five populous countries known as the PICNI countries (Pakistan, India, China, Nigeria and Indonesia), in which approximately 75% of the world's poor (earning less than $ 1.25 a day per capita) reside (Sumner 2012a). The graduation of these five countries into the category of MICs (between 1999 and 2008) has largely driven the reconfiguration of the global geography of poverty (Carbonnier and Sumner, 2012). The eight largest countries in the MIC's category – i.e. the five PICNI countries together with Brazil, Mexico and Russia – together account for nearly 80% of the world's poor. Table 2 provides an overview of key figures for these 'big 8' countries.

Table 2: Key figures for the 'big 8' middle-income countries, 2011

Country	Type	GDP (current US$)	GNI per capita (Atlas method, current US$)	Populations (persons)	Percentage of population living below $ 1.25 a day	EU Policy Framework
China	UMIC	$ 7.318 trillion	$ 4,940	1.344 billion	13.1 % (2008)	Strategic Partner
India	LMIC	$ 1.848 trillion	$ 1,410	1.241 billion	32.7% (2010)	Strategic Partner
Russia	UMIC	$ 1.858 trillion	$ 10,730	141.9 million	12.8 % (2011)*	Strategic Partner - ENP
Nigeria	LMIC	$ 244 billion	$ 1,280	162.6 million	68 % (2010)	ACP-EU Cotonou
Indonesia	LMIC	$ 846.8 billion	$ 2,940	242.3 million	18.1 % (2010)	EU-Indonesia Partnership and Cooperation Agreement
Pakistan	LMIC	$ 210.2 billion	$ 1,120	176.7 million	21 % (2008)	EU-Pakistan 5-year Engagement Plan
Mexico	UMIC	$ 1.153 trillion	$ 9,420	114.8 million	1.2 % (2008)	Strategic Partner
Brazil	UMIC	$ 2.477 trillion	$ 10,720	196.7 million	6.1 % (2009)	Strategic Partner
Total		**$ 15.95 trillion**		**3.620 billion**		

Source: World Bank data retrieved from http://data.worldbank.org/ in January 2013 and own analysis.
* measured against the national poverty line of approx. $ 2.5 per day.

These countries are most commonly typified by two characteristics. First, the 'big 8' have all experienced sustained periods of above-average economic growth, with their economies growing more than 5% annually over a period of ten years. Second, these countries have large numbers of inhabitants – estimated data shows that over half the world's population is a citizen of one of the 'big 8' countries. Therefore, they represent large markets, and together generate over 20% of global GDP. Whereas these countries have significant natural resource endowments, the strength of their emergence is mostly associated to the development of significant productive capabilities (in certain cases also a services sector) allowing these countries to compete with developing markets in high-value markets (e.g. consumer goods).

The ‘big 8' have begun to assert themselves in regional and international politics, establishing a presence in the UN General Assembly, the G20 and various regional organisations. This combination of scale effects, material interdependencies and political clout is summarised in the term ‘anchor countries’ (Tilman and Leiniger, 2008).

Much has been written about ‘emerging economies’, which have become increasingly important actors on the regional and the world stage despite experiencing slower economic growth compared to a few years ago. The ‘big 8’ can certainly be counted among them - indeed, these countries and particularly those that increasingly engage in South-South cooperation (Brazil and China, primarily) are to a certain degree the reason for the present EU policy discussions on country classifications and the engagement with the MICs. The common line of reasoning is that ODA has become less relevant to the MICs as they could generate and manage the necessary resources and capabilities to reduce poverty on their own.[15]

However, poverty is certainly not the only issue affecting the MICs, and ODA is not the only tool at the EU and its Member States’ disposal. As poverty reduction often comes a distant second to economic or security interests, and ODA is losing some of its relevance for the MICs (see Section 3.6 below), this objective and tool should not be singled out as the sole determinant of the type and level of support these countries receive. Other potential tools and actions that the EU has at its disposal for cooperating with the MICs are discussed in later sections of this study. Before that, the following section explores several key issues other than poverty which affect the MICs.

3. Framing cooperation with Middle-Income Countries

While the above are widely recognised trends, traditional classification criteria (particularly income measures such as GDP or GNI) are unsuited to capture the full diversity of the middle-income countries. That is not to say that income classifications are factually irrelevant, as policy-makers will still need to differentiate between countries in accessible and justifiable ways. However, closer analysis and ‘unpacking’ of country groupings can help to improve the design and targeting of foreign policy instruments. A review of the existing literature on (cooperation with) the MICs reveals factors beyond income and income growth which do and should play a significant role in the continued engagement with these countries. While the individual issues may not be unique to MICs, their configuration poses unique challenges for external actors, and should therefore be considered when determining the nature and degree of engagement with the MICs.

It should be noted that it is not the objective of this study to develop and propose an alternative classification or taxonomy of middle-income countries.[16] While the various issues and indicators noted can serve to group or classify the MICS, the below analysis instead seeks to provide an accurate description of those factors relevant for shaping further engagement with the MICs.

[15] In effect, this argument implicitly adheres to a particular world-view, which conceives of ‘development’ as being a (generally linear) maturing process towards an end-state of development, in which MICs are at the stage of adolescence. Eyben and Lister (2004).
[16] Harris et al (2009) provides a good overview of existing classifications, whereas Fallon et al (2001) and Tezanos Vázques and Sumner (2012) propose new classifications specifically for middle-income countries.

3.1. Key issues for cooperation with Middle-Income Countries

An early conclusion from the literature on the MICs is that higher average income levels will not necessarily improve country-level conditions – therefore, crossing what some would view as an arbitrary data threshold[17] from LICs to MICs cannot be considered 'development' in and of itself. Studies and reports have linked persistent patterns of poverty in MICs to a range of issues, out of which several issues emerge as being key to their further development:

- **State fragility** is a serious concern for a distinct group of MICs, comprising mostly LMICs. Not only do these countries have more people living below the poverty line of $1.25 per day, but concerns of fragility such as political instability, government capacity, corruption, rule of law and security in general increase the risk of large numbers of people rapidly sliding below this poverty threshold when fragile situations deteriorate. The restoration of security, state sovereignty and legitimacy should be a priority for engagement with these countries – a body of literature indicates that traditional development cooperation approaches may not be the most suited instrument to support such endogenous processes[18];

- Low-income countries achieving higher levels of economic growth and graduating to the MICs category are susceptible to falling into the '**middle-income trap**', primarily caused by **slow or unsuccessful economic transformation**, further fuelled by trade dependence, slow export expansion and commodity-driven growth. The MICs furthermore continue to face high (economic, skill and budget) drains and low capacities for productive development;

- While the cost for reducing poverty is potentially much lower than in LICs (particularly for the UMICs), this advantage has so far not materialised. The literature indicates that poverty in MICs is increasingly an issue of **income inequality** rather than absolute poverty – the decreasing relevance of ODA for many of these countries increases the necessity for effective domestic resource mobilisation (tax revenues and gross capital formation), which are often precarious by being bound to key sectors and exposed to perverse incentives or elite capture;

- Higher growth rates driven by industrialisation have had an impact on the **environmental protection and ecosystem vitality** in the MICs, particularly the 'big 8'. This can negatively affect agricultural production, directly putting at risk already poor communities.

While these issues are 'common' in that they equally affect other countries, in particular the LICs, they have come into starker contrast due to the gains made in reducing poverty and/or increasing income in the MICs. Increasingly, these issues have come to represent the essential development challenge towards which development and other forms of cooperation must be sensitive. Both the configuration and cross-border nature of these problems, which affect countries gaining influence in a world of shifting power dynamics, gives cause for external actors to reevaluate their engagement with the MICs. The following sections provide additional background to the four key issues noted above before concluding by considering the relevance of ODA for cooperating with the MICs.

[17] See Jerven (2012) and Kenny and Sumner (2011)
[18] See Macrae et al (2004) and Takeuchi et al (2011), World Bank (2011).

3.2. Fragility and fragile states

The World Bank maintains a harmonised list of fragile situations which notes 16 MICs (15 LMICs and 1 UMIC, 15% of all MICs) as being **fragile states** or otherwise in a fragile situation, defined as *"Countries facing particularly severe development challenges: weak institutional capacity, poor governance, and political instability."*[19] Such countries are identified as such by means of the Country Policy and Institutional Assessment (CPIA) that assesses the quality of country policies, which can manifest symptoms of fragility in certain sectors or areas of the country.[20] See Table 3 for an overview of these fragile states, noting also which of them are host to on-going political and/or peace-building missions or peacekeeping missions and specific forms of EU support.

Table 3: Countries noted as fragile state or fragile situations and EU political/security engagements

Country	Political and/or peace-building mission	Peacekeeping mission	Current or past EU CSDP / ESDP Mission	Current or past EU Special Representative
Angola				
Bosnia and Herzegovina	X		X	X
Republic of Congo				
Côte d'Ivoire		X		
Iraq	X			
Kiribati				
Kosovo		X	X	X
Libya	X			
Marshall Island				
Micronesia (Fed. States)				
Solomon Islands				
South Sudan		X	X	X
Sudan		X		X
Timor-Leste		X		
Tuvalu				
Yemen				

Source: World Bank Harmonized List of Fragile Situations for the financial year 2013, accessed at http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1269623894864/FCSHarmonizedListFY13.pdf,, and official map of CSDP missions accessed at http://www.consilium.europa.eu/media/1822904/map_en_decemberwl.pdf in December 2012.

In several cases, countries have emerged from conflict(s) or crises as highly fragile middle-income countries (such as Iraq, Sudan, Timor-Leste, but also Pakistan, Nigeria and Yemen). Large numbers of people in these countries live close to the international poverty thresholds of $1.25 and $2 per day per capita. Together these so-called 'middle-income but failed or fragile states' (MIFFs)[21] account for roughly 180 million (or 17%) of the global population living on less than $1.25 a day, which is more than the same amount for people living in more stable poor countries (10%) (Gertz and Chandy 2011, Kharas and

[19] See http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/STRATEGIES/EXTLICUS/0,,contentMDK:22230573~pagePK:64171531~menuPK:4448982~piPK:64171507~theSitePK:511778,00.html. There are a number of other listings of fragile, failed and conflict countries maintained by other organisations. The EC has its own list but this is not a public document.
[20] See IEG (2009) for a description and evaluation of the CPIA.
[21] See The Economist (2011)

Rogerson, 2012).[22] These countries have displayed the most movement between income classifications over the past 25 years, and have furthermore experienced a rapid growth of the number of poor people since 2005 (from 15 million to 180 million). State fragility therefore risks rapidly sliding these countries and/or significant numbers of people below poverty thresholds (World Bank 2011).

Importantly, countries such as Angola, Pakistan, Cote d'Ivoire, Nigeria, Yemen and Sudan are regional poles of power, owing in part to their size and/or resource wealth. Although none of the 'big 8' countries are classified as fragile states according to the World Bank's definition, several of them (particularly Nigeria, Pakistan and Indonesia) score low on international rankings on state capacity and accountability (such as the World Bank's World Governance Indicators or WGI[23]), revealing important aspects of fragility. Their fragility and instability have a direct impact on their respective regions, triggering wider political crises in surrounding countries and affiliated regional organisations and institutions, as well as causing economic shocks to the regional economy.

Furthermore, the significance of these countries also affects the politics and economics of developed countries, whose commercial and investment interests are closely tied to large markets and natural resource endowments. These aspects are recognised as having an impact on the EU, as is the fact that there are wider strategic as well as poverty consequences (notably threats to security and other global public goods and loss of influence) that occur from fragile states and situations.

3.3. The middle-income trap

Middle-income countries are said to be at risk of falling into the so-called **'middle income trap'**. This trap is defined as a situation where countries are not able to sustain high (enough) growth rates in order to develop into high-income countries, principally due to rising domestic wages leading to increased competitive pressures in key export markets and the erosion of comparative advantage. The phenomenon is linked to (the speed of the) changing structure of the economy, types of goods exported, low investment ratios and limited economic (or industrial) diversification. Specifically, the country's productive sector ends up being 'trapped' producing and exporting manufactured goods that are both unsophisticated (i.e. with little opportunities for innovation or improvements in the production process, and thus few wage advantages and little profitability) and not particularly well-connected to other goods (i.e. those with few opportunities for economies of scope).

Though the phenomenon is widely ascribed as applying to the 'emerging' Asian economies, a total of 14 LMICs and 20 UMICs are estimated to be trapped in addition to the Asian economies, as listed in Table 4. (Felipe 2012)

[22] It should be noted that this figure is highly influenced by Pakistan, which with an estimated population of 187 million inhabitants in 2011 is much bigger than the other countries of this group.
[23] See http://info.worldbank.org/governance/wgi/index.asp. For other measures of state fragility, conflict and security, see http://www.fundforpeace.org/global/?q=fsi-about and see Scheye (2009).

Table 4: Countries estimated to be in the middle-income trap in 2010

Albania	Guatemala	Philippines
Algeria	Iran	Romania
Bolivia	Jamaica	South Africa
Botswana	Jordan	Sri Lanka
Brazil	Lebanon	Swaziland
Colombia	Libya	Syria
Congo, Rep.	Malaysia	Tunisia
Dominican Republic	Morocco	Uruguay
Ecuador	Namibia	Venezuela
Egypt	Panama	Yemen
El Salvador	Paraguay	
Gabon	Peru	

Source: Felipe 2012

Though the MICs do command considerable trade and foreign direct investment flows, trade dependence is prevalent among the MICs – 29 MICs have a trade volume which exceeds the value of their GDP.[24] The trap reflects the fact that growth which is based entirely on expanding exports of consumer goods (the so-called 'flying geese' model of development) is dependent upon the presence of opportunities to create export markets by other countries diverting production (either by producing more sophisticated good or by transforming their economic structure, e.g. the rise of a services sector). It remains an obstacle for many MICs that the emerging economies predominantly import consumer goods from high-income countries rather than from other MICs (Paus 2012).

Other countries, notably Angola, the Republic of Congo and Turkmenistan, have economies that are largely driven by the exploitation of natural resources – the percentage of GDP generated from natural resources rents in these countries can be over 60%. Countries whose economy leans on the exports of raw commodities are likely to be more economically vulnerable due to their susceptibility to short-run commodity price fluctuations. Certain commodities may furthermore be non-renewable, which raises the question of how the economy can adapt once these run out (e.g. some diamond or copper oriented economies in Sub-Saharan Africa).

3.4. Income inequality

Declining income growth or growth not accompanied by proportionate rises in employment and wages (jobless growth) brings existing societal problems into perspective. Specific contentious issues include the divide between those benefiting from the recent growth and the persistently poor, pervasive corruption, the pressures of urbanisation, shortages in public services, unemployment, social unrest, lack of trust, and a weakened financial system.

Particularly prominent is the commonly noted high level of income inequality in the MICs. Aggregated data (see Table 5) shows that over a third of GNI is accrued by the richest 10% (decile) of the population – significantly more than the poorest 40% (the only clear exception being Pakistan) (Sumner 2012b, Palma 2011). Income inequality appears to be more pronounced in UMICs than in LMICs, and occurs most acutely in Latin America and individual countries in Sub-Saharan Africa (e.g. Angola and Nigeria).

[24] Several European countries, such as Luxembourg, the Netherlands, Estonia, Slovakia, Lithuania and Belgium, are also confronted with this issue.

While there are various definitions of inequality[25], domestic and international policy-makers are predominantly concerned with income inequality as being both a cause and an outcome of persistent poverty. Of recent, income inequality has been more explicitly linked to political unrest and social instability (or lack of social cohesion) as a result of the Arab Spring. Recent studies by the IMF and UNICEF moreover find that longer growth spells are strongly associated with higher levels of equality in income distribution (Furness and Negre, 2012).

Table 5: Inequality estimates from income distributions (from Sumner, 2012b - nearest available data, population weighted)

	LICs	LMICs minus India	UMICs minus China	All LMICs	All UMICs
GNI to poorest 20% (%)	7.9	7.3	4.9	8.0	4.9
Poorest 4 deciles (D1–D4)	19.5	18.4	13.9	19.6	14.5
Middle 5 deciles (D9–D5)	51.1	51.2	49.8	51.1	51.8
Richest decile (D10)	29.4	30.4	36.3	29.3	33.7

Source: Data processed from PovcalNet (World Bank, 2012).

While the emergence of a middle class and private sector offers the potential for the MICs to generate much higher tax revenues than the LICs or LDCs, several considerable obstacles keep taxation from being the conduit for income redistribution. Notwithstanding the capacity gaps of tax administrations in many MICs, as well as the possible lack of political will for implementing progressive tax systems, LMICs have been found to require unrealistically high marginal tax rates (of over 50%) in order to effect redistribution to reduce the number of poor people in-country by half (Ravallion 2009 and 2012). Simultaneously, human and asset capital flight are significant drains on the tax base for MICs.

3.5. Environmental and economic vulnerability

As many MICs are in the process of industrialising and are furthermore to a degree dependent on gains from extractive industries, it is unsurprising that the MICs category contains some of the worst performers in terms of environmental conservation and preservation.[26] Although the MICs vary greatly in their environment and ecosystems, most perform somewhat better than, for instance, OECD member countries. Notable exceptions are the MICs in the Middle East and Central Asia, which experience high levels of air and water pollution as well as environmental burden of disease and low levels of ecosystem vitality.

The ‘big 8’, meanwhile, display strong ecosystem effects of water pollution from their rapid industrialisation and export-driven expansion. Negative incentives in agricultural subsidies and pesticide regulation furthermore have a strong impact on the agricultural prospects of the weakest performers in the group (South Africa and India), while high rates of CO2 emission in the rapidly industrialising countries (mostly the ‘big 8’ but also other UMICs) is also having negative externalities for the environment. In these countries the aforementioned rise of a strong middle class is expected to further increase consumption patterns and thus put a strain on environmental quality, which would challenge such countries to gradually set binding targets on the use and efficiency of land, water and energy. One telling example is that out of the 23 water-scarce countries 12 are MICs and only three are LICs (ERD 2011).

[25] These are most often linked to (perceptions of) social and economic exclusion. See Humphrey (2001) and Eyben and Lister (2004).

[26] Measured according to the Environmental Performance Index (EPI), retrieved from http://epi.yale.edu/dataexplorer/tableofmainresults in December 2012.

Unsurprisingly, the MICs vary greatly in their size and geography. Notably, 15 countries in the MICs category are landlocked, out of a total of 48 landlocked countries worldwide. A notable cluster of landlocked MICs can be found in Central Asia (Kazakhstan, Mongolia, Uzbekistan and Turkmenistan), while the other landlocked MICs generally form part of larger clusters of landlocked countries (e.g. in the Sahel countries, Southern Africa and some of the Western Balkans). Moreover, a total of 29 MICs are classified as Small Island Developing States (SIDS).[27]

Both landlocked states and the SIDS are more economically vulnerable than the average MICs, and also more so than some LICs (e.g. Kiribati and Suriname). These categories of countries are associated with a particular set of vulnerabilities and challenges for sustainable development, including: remoteness, vulnerability to external shocks, trade dependence, high costs of communication, energy and transportation, and few opportunities for economies of scale (compounded for several small landlocked countries and the SIDS in general, who have little natural resources to draw on). SIDS are furthermore susceptible to natural disasters and environmental fragility, both constraining their fiscal and policy space.[28]

3.6. The relevance of ODA for cooperation with the MICs

While it is beyond the scope of the present study to go any deeper into the above issues, further efforts to engage with the MICs for poverty reduction should acknowledge that these issues are strongly linked to persistent poverty in MICs. Annex II provides an overview of the issues along with indicators for measuring and monitoring them.

MIC governments and societal actors are best placed to respond to these, yet policies and operations of the MICs to address these challenges can still benefit from external support. However, it should be kept in mind that ODA may not be the best choice as a basis for cooperation on these issues, particularly as the absolute and relative influence of ODA on global development has declined during the past and current decade due to four trends:

1. Developing countries' own growing domestic resources;
2. The faster growth of other international financial flows and contributions compared to ODA (remittances, Foreign Direct Investments);
3. Increasing development assistance from other governmental, non-governmental and private actors that do not report their support as ODA;
4. And the process of globalisation that increasingly intertwines the policies and actions of states and regions with one another.[29]

Notably, ODA makes up less than 1% of GNI on average for the PICNI countries, which indicates that most poor people currently live in countries that are not dependent on ODA (Glennie 2012). Development cooperation funding is furthermore rapidly declining in a relative sense in a number of other MICs such as Angola, Côte d'Ivoire, Egypt, Sri Lanka and Yemen. Contrarily, for the small island developing states ODA continues to make up a considerable percentage of annual GNI, notably being over 30% in Micronesia, the Solomon Islands, the Marshall Islands and Tuvalu. There are furthermore larger economies such as Kosovo and Nicaragua, where ODA flows make up over 10% of GNI. ODA also represents 1.5% of gross capital formation for MICs. While this factor is higher in LMICs than in UMICs, it is still a good indication that there are significant sources of external flows other than aid.

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[27] See http://www.unohrlls.org/en/lldc/31/ and http://www.unohrlls.org/en/sids/43/

[28] For some Caribbean MICs the impact of natural disasters has been estimated as being over 100% of their GDP levels: http://www.itu.int/ITU-D/emergencytelecoms/events/CaribbeanForum/documents/Day1/Ms_Sandra_E_John.pdf

[29] See Keijzer (2012).

Tax revenues are often hailed as an essential component for inclusive and sustainable development. The potential for generating domestic resources renders the cost to donors for reducing poverty in the MICs much lower (Sumner 2012), and offers a compelling reason for exploring partnership objectives beyond poverty reduction while remaining informed of the shortcomings noted in the previous sections.

Actors wishing to cooperate with the MICs should further recognize the contribution that the MICs (can) make to global public goods, including those closely linked to EU values and interests (inter alia poverty reduction, financial stability, public health, environmental protection, capital and labour mobility, and trans-border crime and conflict). Furthermore, the emergence of many MICs (not only the 'big 8') as credible political and strategic partners in areas such as trade, security and energy must be explicitly acknowledged in (re)forming partnerships. The EU's wider interests, notably the provision of global public goods and security and access to trade opportunities and natural resources, warrant further engagement of the EU with the MICs.

However, this engagement would need to be managed and shaped differently from the typical development cooperation-driven contexts, reassessing also the tools used. Realising this diversification of cooperation will require, in the first instance, clarifying how areas of engagement beyond traditional development cooperation link to poverty reduction in MICs, as well as what other shared objectives and priorities can form the basis of any potential partnership.

Although there are important variations among MICs, they are to a certain degree typified as having more capacities or better opportunities for reducing poverty when compared to the LICs. The actual capacities and opportunities need to be taken note of for each country and linked to decisions on how to apply specific instruments that can be employed to optimally utilise them. A 2007 UNDESA report notes that development strategies and instruments used to support the MICs should concentrate on: 1) consolidating efficient and credible institutions; 2) reducing the MICs' vulnerabilities associated with their integration into international financial markets, and; 3) improving the MICs' competitive capacity through productive transformation and technological progress. (UNDESA 2007) As the largest trading block in the world that thrives on stability and growing distant markets it goes without saying that the effective pursuit of these three areas in MICs would also serve the EU's own interests.

For the EU, this would require an engagement beyond the current development cooperation frameworks used for the majority of MICs, in addition drawing on the full range of tools at the EU's disposal (as will be discussed in Section 5). In many MICs, however, the EU struggles to broaden cooperation beyond ODA. The next sections will analyse to what extent the EU has committed to and avails of sufficient technical expertise and political capacity to effectively cooperate with MICs.

4. Commitments, opportunities and challenges for EU cooperation with MICs

The EU's engagement with the MICs is driven by multiple interests beyond poverty reduction, and is shaped by a number of different policy frameworks with associated objectives. This section gives an overview of the EU policy commitments affecting the MICs, and analyses the opportunities and challenges that these afford cooperation with the MICs going forward.

4.1. EU Treaties: objectives, values and principles of development cooperation

The EU's engagement with the MICs outside of its immediate neighbourhood has traditionally been framed by its principles and objectives of development cooperation and humanitarian assistance. Both forms of cooperation fall within the framework of the principles and objectives of the Union's external action and are thus part of the EU's endeavour to reconcile the Union's values[30] and interests abroad and contribute to inclusive and sustainable development outside the EU's borders that in turn serves such development in the EU. The EU Treaty further states that EU development cooperation is to serve one primary objective regardless of the country and regional context in which it is applied, namely *"the reduction and, in the long term, the eradication of poverty"* (Art. 208, Council of the European Union 2010).

Essentially, the EU's stated primary interest for development cooperation with the majority of MICs is poverty reduction and eradication. The Treaty however does not define the concept of poverty. The most authoritative policy document in this regard is the European Consensus on Development that was adopted in December 2005 by the EU Member States, the European Commission and the European Parliament. It includes a multi-dimensional definition of poverty[31], but this broad understanding is not restrictive in the sense that the EU can set priorities on which aspects of poverty it wants to concentrate. Accordingly, stated commitments vary from individual MDG indicators (for specific development cooperation instruments) to the equally broad concept of 'inclusive and sustainable growth'.

The EU thus has more flexibility in practice in giving shape to its development cooperation than the Treaty would at first look seem to suggest. The European Consensus on Development further notes that despite the priority given to Least Developed Countries and other LICs, *"[t]he EU also remains committed to supporting the pro-poor development of middle-income countries (MICs), especially the lower MICs."* Paragraph 61 of the European Consensus further clarifies the EU's motivations behind this commitment:

> *"Many lower MICs are facing the same kind of difficulties as LICs. A large number of the world's poor live in these countries and many are confronted with striking inequalities and weak governance, which threaten the sustainability of their own development process. (…) Many MICs have an important role in political, security and trade issues, producing and protecting global*

[30] The EU Treaty sets out the Union's values as "peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights" (Council of the European Union 2010). These values have to be reconciled with the EU's own economic, governance and security interests in developing countries as well as on the global stage.

[31] Paragraph 11 defines poverty as follows: "Poverty includes all the areas in which people of either gender are deprived and perceived as incapacitated in different societies and local contexts. The core dimensions of poverty include economic, human, political, socio-cultural and protective capabilities. Poverty relates to human capabilities such as consumption and food security, health, education, rights, the ability to be heard, human security especially for the poor, dignity and decent work. Therefore combating poverty will only be successful if equal importance is given to investing in people (first and foremost in health and education and HIV/AIDS, the protection of natural resources (like forests, water, marine resources and soil) to secure rural livelihoods, and investing in wealth creation (with emphasis on issues such as entrepreneurship, job creation, access to credits, property rights and infrastructure). The empowerment of women is the key to all development and gender equality should be a core part of all policy strategies."

> *public goods and acting as regional anchors. But they are also vulnerable to internal and external shocks, or are recovering, or suffering, from conflicts."*

The paragraph above clearly reflects the key issues faced by the MICs identified in previous sections. The reference to the idea of MICs as 'regional anchors' is also particularly compelling in the sense that this could justify using European ODA in specific countries (for instance the 'big 8') to 'catalyse' or ensure the sustainability of the results achieved in neighbouring LICs and MICs.[32] It also serves to acknowledge the political weight of some of the EU's partners.

4.2. Recent EU policy commitments for development

The EU's recently adopted new development cooperation framework, the 'Agenda for Change' notes that the EU will continue to cooperate with "more advanced countries", which are key partners to address global challenges and where poverty and inequality remain widespread, through "new forms of strategic cooperation" rather than bilateral grant aid (European Commission 2011a). Indeed, the Council Conclusions describe how the EU wants to allocate its budget and shape its partnerships (Council of the European Union 2012):

> *"In* [the] *future, the scope of the partnership and the corresponding resource allocation will be determined on the basis of: i) country needs (including economic and social trends, as well as vulnerability and fragility), ii) capacity, iii) country commitments and performance and iv) potential impact. This will allow the EU to adapt its support (the mix and level of aid) to the country's situation and progress in its commitment to and record on human rights, democracy and the rule of law, ability to conduct reforms and to meet the demands and needs of its people. This differentiation should lead to a more effective policy mix, appropriate aid levels, as well as efficient aid arrangements and the use of new and existing financial tools."*

The Agenda for Change thus formulates a clear position on how the EU should engage with the MICs. Whereas it proposes to target the EU's development cooperation efforts and resources towards countries 'most in need', including fragile states, where it can have the largest impact, concentrating on Europe's neighbourhood, Sub-Saharan Africa and Least-Developed Countries (LDCs) elsewhere, the MICs are not overlooked.

Comparing the above text to the paragraph cited from the European Consensus on Development in the previous section, it seems that EU development policy has evolved from a focus on justifying the use of its ODA to specific groups of countries to a more 'country-specific' approach whereby EU development cooperation is tailored to the specificities of individual countries in order to maximize impact. In particular, new ways of working together beyond the traditional donor-recipient relationship will be explored with partner countries already on sustained growth paths and/or able to generate sufficient resources on their own.

Even though no explicit references to (specific MICs as) regional anchors can be found in the texts, the need to differentiate between countries is a clear thread running through the more recent policy documents. Three different types of differentiation are applied in formulating the EU's development cooperation with specific partner countries (Keijzer et al 2012):

[32] A detailed research project on anchor countries was carried out by the German Development Institute (DIE), key outputs can be accessed here: http://www.die-gdi.de/CMS-Homepage/openwebcms3_e.nsf/(ynDK_contentByKey)/MSIN-7PKFAV?Open&nav=expand%3AResearch%20and%20Consulting%5CZusatzdokumente%3Bactive%3AResearch%20and%20Consulting%5CZusatzdokumente%5CMSIN-7PKFAV

- **Differentiated mix of policies and instruments**, promoting the use of an optimal mix of policies, approaches and instruments adapted to countries' development situation. This implies furthering cooperation in other areas 'beyond aid' and the use of innovative sources of financing when appropriate.
- **Differentiated levels of development assistance**, whereby country aid allocations are differentiated on the basis of specific criteria. The citation above implies that bilateral grant aid to more advanced countries will be reduced, with priority given to LDCs, LICs and fragile situations. In addition levels of ODA can be differentiated according to capacity as well as commitment and performance.[33]
- **Differentiated eligibility to development assistance**, proposing to phase out bilateral development grant assistance to countries in upper-middle- or higher-income categories.

The practice of differentiated allocation levels and mixes of policies and instruments features prominently in the proposal for an Instrument for Development Cooperation (DCI) for 2014-2020, which notes that the EU wishes to *"(…) engage in new partnerships with countries that graduate from bilateral aid programmes, notably on the basis of regional and thematic programmes under the new DCI, thematic financial instruments for EU external action and the new Partnership Instrument"*[34]

Moreover, the EU's Development Cooperation Instrument (DCI) comprises a large thematic programme to support the provision of global public goods in the areas of environment and climate change, sustainable energy, human development, food security and sustainable agriculture and migration and asylum. Clear commitments are made in the proposal to allocate minimum percentages of the overall funding to each of these goods (e.g. 25% of its funds should cover climate change and environment-related support).

A new EU financial instrument for external action proposed for the period 2014-2020 that could conceivably address the Union's cooperation with MICs on challenges of global concern is the Partnership Instrument. The instrument aims to advance and promote EU and mutual interests, particularly with strategic partners and emerging economies. The instrument can but does not necessarily have to include expenditures that can be classified as ODA. Though limited in size[35], the instrument is expected to play an important catalyzing role, for example by funding activities that promote policy dialogue and contribute to developing collective approaches and responses to global challenges such as energy security, climate change and environment. It remains to be seen how the instrument will perform and what balance will be struck between the promotion of EU economic self-interests versus mutual interests in addressing challenges of global concern.

In summary, the EU's current development cooperation framework acknowledges the special nature of the MICs, and proposes to actively seek new instruments and partnerships for cooperation going forward. The EU further recognizes the MICs' crucial contribution to the provision of global public goods. The proposed instruments for development cooperation for the period 2014-2020 are applicable to the majority of MICs, and target several of the key issues they are faced with directly, and most of them indirectly.[36] Box 1 provides a summary overview of the areas targeted.

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[33] This can be most clearly seen in the European Neighbourhood and Partnership Instrument (ENPI) under the label 'more for more'. The same principle can also be found in the practice of using 'performance tranches' as part of EU General and Sectoral Budget Support operations.

[34] See European Commission (2011c), page 7.

[35] The Commission has proposed an amount €1.131 billion for the Partnership Instruments covering the period 2014-2020. The final amount will be determined by the outcome of the negotiations with the EU Member States in the Council and the European Parliament.

[36] While it is as of yet unclear how much ODA will be allocated to the MICs by the EU over the period 2014-2020, over € 3.7 billion were allocated to MICs (excluding LDCs) for the period 2007-2013, constituting roughly half of all EC ODA allocated for that period. Of this allocation, roughly 1.5 billion was allocate to the PINCI countries (Herbert 2012).

Box 1: Summary overview of areas of cooperation targetting MICs in the EU's proposed instruments for development cooperation 2014-2020

- Although targeted towards those countries most in need, **LMICs** are eligible for funding and targeted development actions through all the EU's instruments for development cooperation, whereas **UMICs** are likely to receive less aid or be ineligible for aid from certain instruments;
- **Fragile states and situations** are noted amongst those countries most in need, and are thus eligible for funding through most EU instruments rather than only the Instrument for Stability (see Görtz and Sherriff 2012). However, some development funds (particularly those managed by partner government authorities) can be frozen in certain cases, such as outbreak of conflict or evidence of mismanagement, both of which are more likely to occur in fragile states;
- **Economic vulnerability** is one of several factors weighed in deciding on allocations of ODA through the geographic programmes. Furthermore, the Aid for Trade agenda has been gaining some traction in EU development cooperation (Lui et al 2012) – the Agenda for Change acknowledges a stronger business environment and regional integration as enabling to inclusive and sustainable growth. However, these commitments are less clearly expressed in the instruments, and no mention is made to export diversification or other means of overcoming the middle-income trap;
- **Income inequality** is not explicitly referred to in the policy documents. Instead, the Agenda for Change notes inequalities of opportunity and advocates measures to support and develop social protection schemes and systems in partner countries, which may include income guarantees. Furthermore, cooperation in the areas of tax governance and administrations are also noted in the DCI's geographic programmes.
- Several areas of **environmental conservation and protection** are covered by the DCI's thematic programme for global public goods, referring to assisting partner countries to achieve the MDGs and other international targets related to the sustainable use of natural resources and environmental sustainability. Whereas most **landlocked** and **small-island developing states** have access to bilateral aid programmes, no specific (thematic) funding programme exists for these countries.

With the overarching objective of poverty reduction providing an open framework for what can be done in terms of development cooperation, the EU has been relatively explicit on the areas of development it wishes to engage in. The policy principles and objectives put forward go some way towards explaining how the EU will concretely manage the reinvention of its poverty-focus in EU development cooperation towards a focus on promoting 'inclusive and sustainable growth', which implies taking specific actions in the MICs that include the most unequal societies in the world, including notably fragile states.

4.3. Other EU external action policy commitments affecting the MICs

The EU's engagement with MICs does not begin or end at development cooperation. Indeed, the EU engages with MICs and other countries in a wide number of policy areas, pursuing multiple objectives. Table 1 in Section 2.2 already presented a quick overview of the relevant policy frameworks. This section assesses how the EU distinguishes between countries in specific policy areas, and how these distinctions affect MICs.

Aside from EU development policy, **trade policy** is the only other area of cooperation where the EU explicitly distinguishes the MICs based on one of the international classifications. The 2012 EC Communication on Trade, Growth and Development proposes a reform to the EU's Generalised Scheme of Preferences (GSP) in light of "*the growing differences between developing countries and their disparate needs […] suggests reviewing eligibility criteria and graduation mechanisms to ensure that only LDCs, low- and lower-middle income countries actually benefit from the system in sectors where help is needed.*" (EC 2012a).

A total of 12 UMICs[37] will hence no longer benefit from the scheme. Imports from UMICs which do not have a separate Free Trade Agreement (FTA) with the EU will face higher tariffs - for these countries, the loss of duty restrictions on trade in goods may worsen their chances of escaping the middle-income trap (e.g. for Brazil and Malaysia). Furthermore, eight countries face product graduation: China, India, Indonesia, Iraq, Nigeria, Thailand, Ukraine and Vietnam will no longer enjoy duty restrictions on key goods. The EC notes that the "Negative impacts on these countries' exports are typically marginal (total exports fall by less than 1%)." (EC 2012 a). The decision to differentiate between UMICs and less developed countries rests on the idea that UMICs are less in need of of trade preferences due to their higher level of competitiveness on international markets. Further, the EC argues that differentiating in the GSP will have positive effects for LMIC, LICs or LDCs, although the magnitude of this positive effect is contested (ODI 2012).

The Union's commitment to **cohesion** presents an alternative perspective on cooperation with MICs. Through its Cohesion Policy, the EU aims to reduce disparities within the Union by targeting disadvantages regions, including in those MS that fall in the group of UMICs (Bulgaria, Latvia, Lithuania and Romania). Article 174 of the Treaty sets out the following overall commitment of the Union in this respect:

> *"In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion. In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions. Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions."*

Given the policy's concentration on the EU, countries are differentiated in more detail than for development cooperation or trade policy. For the upcoming period of cohesion funding (2014-2020), countries will be assessed against a series of indicators matched to three targets of the 'Europe 2020 Strategy': Smart, Sustainable and Inclusive Growth'. EU countries and regions within them will be compared to the EU average performance, and ranked against the best and worst performers. Notably, key issues and trends affecting the wider group of MICs noted in Section 2 and 3 – such as demographic pressures, urbanization, competitiveness, quality of governance, remoteness, environmental sustainability and income inequality – feature heavily in the instruments and programmes proposed in the Cohesion Policy.

The EU therefore differentiates its own countries based on sophisticated statistical profiles. In part, this is difficult to scale up to policy areas affecting countries globally (e.g. development cooperation and trade) due to the capacities needed to generate, disseminate and interpret such large quantities of data. However, these profiles form part of a structured political dialogue process with the Member States and disadvantaged regions on their development and relation to other parts of the Union.

Another process that runs concurrent to the cohesion process is the **enlargement** process. The policy for enlargement is driven by the criteria for accession. Whereas the presence of stable governance structures and a competitive market economy are important factors for the EU in determining which countries can become accession candidates (aside from the obvious criteria of geographical proximity), the impetus for the enlargement discussions occurs through political will and ensuing statements of intent.

[37] Namely: Argentina, Brazil, Cuba, Uruguay, Venezuela, Belarus, Russia, Kazakhstan, Gabon, Libya, Malaysia and Palau.

Income category does not seem to play a role in this, as more and more UMICs have joined in recent rounds of accession. Aside from Croatia (which is a HIC), all other current candidate countries (i.e. Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia and Turkey) are MICs. Indeed, this is the first time that LMICs are considered for accession – Albania and Kosovo.

Beyond that, it is telling that there is no single enlargement policy document in recognition of the fact that it is an evolving process of political bargaining. Indeed, the enlargement process includes the harmonization of national laws of candidate countries to the EU's laws (also referred to as European integration) with the help of EU-funded technical assistance (channeled through the Instrument for Pre-Accession Assistance or IPA). More tellingly, the enlargement process is managed according to bi-annual strategies concentrating on specific regional issues and tensions such as the cooperation and reconciliation in the Western Balkans.

With its **Neighbourhood Policy**, the EU specifically targets non-candidate countries located on or near the EU's geographic outer borders. The EU is committed to support the progress towards democracy and sustainable economic and social development in its nearest sphere of political influence, and promotes regional integration and partnerships such as EuroMed and its successor the Union of the Mediterranean. Association Agreements are concluded with countries in the neighbourhood, noting commitments to political, macroeconomic, trade or legal reform in the neighbourhood country in exchange for financial and technical assistance for these reforms and tariff-free access to specific EU markets.

The European Neighbourhood Policy (2011) stresses a normative form of differentiation, termed the 'more for more' principle and described as *"(…) only those partners willing to embark on political reforms and to respect the shared universal values of human rights, democracy and the rule of law have been offered the most rewarding aspects of the EU policy, notably economic integration (based on the establishment of Deep and Comprehensive Free Trade Areas - DCFTAs), mobility of people (mobility partnerships), as well as greater EU financial assistance. Equally, the EU has reacted to violations of human rights and democracy standards by curtailing its engagement."*[38]

Popescu (2011) suggests that the principle points to a 'meritocratic' Neighbourhood Policy and concludes that although the concept is laudable and clear, it is also to a large extent slippery. He argues that *"(…) the real geographic division inside the neighbourhood policy is not only between states that are south or east, but also between states that are closer or further away from the EU"* – a normative approach to differentiation would therefore favour a strong focus on specific countries in the neighbourhood. However, the inverse of the principle (i.e. 'less for less') appears not to be part of the ENP - a letter by High Representative/Vice-President Ashton and Commissioner Füle to EU Foreign Ministers notes that "*partners that have not embarked upon or undertaken significant reforms designed to build and/or consolidate democracy since the review of the ENP should not benefit from an increased offer but should also not be negatively affected in their relations with the EU*".[39]

Popescu furthermore notes that the 'more for more' principle goes beyond the use of ODA and suggests a broader and stronger political engagement in its Neighbourhood. This presents an important lesson for the EU's engagement in MICs but also one that raises challenges for the EU's coordination capacity and leadership: *"(…) even if the EU starts spending more in the neighbourhood countries that deserve it, the even more difficult question is whether the EU has the will and the unity to become more of a political and security actor in this region as well."*

[38] See European Commission (2012d)
[39] See Young (2012)

In addition, the EU has policy commitments towards resolving two of the key issues affecting the MICs – fragility and environmental vulnerability. First, conflict prevention and fostering peace internationally are clearly stated objectives of the EU's **Common Foreign and Security Policy** (CFSP) and subsidiary Common Security and Defence Policy (CSDP) in the Lisbon Treaty. The EU has accordingly made numerous commitments in this area to use its civilian and military assets for peacekeeping, conflict prevention, crisis management and strengthening international security, and implemented a variety of missions around the world.

The need for and nature of conflict prevention, peace-building or crisis management missions is not linked to the income category of the country or countries in which they take place. Rather, the decision to design and implement a CSDP mission is based on joint analysis and agreement of the EU Member States, always involving consultation, agreement and invitation by the host government. CSDP missions undertake a wider variety of tasks such as building the capacity of the police, judiciary and customs reforms and monitoring ceasefires. More robust peacekeeping missions have also been mounted, while political engagement is sought to facilitate and live up to agreements to end hostilities.

Furthermore, although CFSP and CSDP respond principally to fragile or crisis situations rather than countries (and can hence span more than one country), the 2003 European Security Strategy notes that the best protection for the EU security is a world of well-governed democratic states. There is hence scope for the EU to cooperate with MICs that are fragile states or experience fragile situations as well as partner with them in supporting the addressing of fragility elsewhere (such as with South Africa – see Section 6).

Second, the EU is prominently involved in international negotiations on **climate change mitigation and sustainable development**. In the context of the Kyoto Protocol, there has always been a certain degree of differentiation between countries (primarily based on the extent to which these countries have industrialised) applying the UNFCCC principle of 'common but differentiated responsibilities and respective capabilities' or CBDR.

This principle notes that, while the protection of the environment at the national, regional and global levels is the responsibility of all states, the level of responsibility borne by individual states must be differentiated. As such, different (lower) emissions reporting and environmental protection standards apply to developing countries. Most MICs are part of the so-called 'Non Annex-I' list of developing countries, and are as such recognized as being vulnerable to the adverse effects of climate change, noting particularly small-island developing states, those heavily reliant on income from fossil-fuel production and trade.

In recent negotiations, the EU has taken the explicit position that the CBDR principle must be adapted to reflect present realities – particularly, all countries must sign up to binding emissions targets and emerging economies (specifically Brazil, Russia, India, China and South Africa – the so-called BRICS countries) should make significant commitments to reduce their emissions. The EU thus clearly differentiates on a country-by-country basis in formulating a position for climate negotiations.

In conclusion, the multiplicity of policy commitments towards or affecting the MICs is both a benefit and a concern for further cooperation with the MICs. On the one hand, the EU can employ a diverse array of instruments at different times and for different purposes. There are thus a large number of imaginable configurations of instruments with which to engage with MICs, which ensures that the EU will most likely be able to identify and form partnerships with MICs on the basis of diverse sets of mutual interests.

On the other hand, the various commitments and the instruments attached to them operate at different 'speeds': they are driven by different interests and events, and cannot be adapted to suit unilateral interests with great ease. The policy frameworks furthermore do not affect all MICs equally, so some picking and choosing is required. For those concerned with poverty, there is also the added concern that these instruments may not always have a positive developmental impact.

The EU will therefore have to invest in exploring its wealth of policy frameworks and instruments in order to identify lessons and best practices to inform the negotiation and design of partnerships and instruments for cooperation with the MICs. The next section will therefore take a closer look at what (ODA and non-ODA) instruments, modalities and budgets the EU has available and to what extent it can sufficiently and effectively make use of its full palette of external actions when seeking to engage with the MICs.

5. EU instruments and modalities for engaging with MICs beyond development cooperation

In the context of discussions on how to cooperate with MICs to address key issues affecting them and further the EU's strategic interests, the EU is challenged with providing the tailor-made policy frameworks, instruments and modalities to ensure a menu of options with which to effectively differentiate (between) MICs. While it is not practically feasible to transpose each EU instrument or policy framework to the MICs, the lessons drawn from them can serve to inform the conception and design of new policy frameworks and instruments for the EU's engagement with the MICs.

Specific instruments that have new or notably different implications for the EU's partnership with the MICs include:
- **Innovative forms of development financing**, including 'blended' loans and grants;
- **Cohesion funds** and instruments;
- Funds and instruments targeting the EUs immediate **neighbourhood**;
- Support to international or regional **peace and security interventions**;
- **Strategic partnerships**.

This selection of instruments is not limited to any single policy area – indeed, several commentators have noted that the strength of the EU lies in the diversity and applicability of its toolbox.[40] The following subsections will analyse the above instruments in turn to highlight their relevance for cooperation with MICs, as well as outstanding issues and drawbacks of these instruments. New developments and lessons learned will also be noted for each of them.

5.1. Innovative forms of development financing

Whereas in the first decade of the new millennium the European Commission explicitly and proactively profiled itself as a leader in the aid effectiveness agenda[41] there has been increasing criticism of the

[40] The authors are conscious of the fact that trade agreements also has a significant impact on cooperation with and the development of the MICs, and indeed that MICs face special considerations in negotiating such trade agreements due to the GSP's differentiation of LMICs and UMICs. However, as there are largely technical issues that fall outside the scope and tone of the present policy discussion, trade agreements will not be treated in this study. For some analysis on this issue, see ODI 2012.

[41] Notably, Paragraph 32 of the European Consensus on Development set additional objectives to the EU that were more ambitious than the 2005 Paris Declaration on Aid Effectiveness, and later in the decade the Commission managed to delegate one of its Director Generals[41] to co-chair the OECD/DAC Working Party on Aid Effectiveness leading on the preparation of the 2011 Busan High-Level Forum. Among other outcomes the EU's engagement culminated in strong

'government-to-government' focus implied in most of the EU's instruments and modalities for development cooperation. More recently, there have been strong calls for engaging more directly with the private sector in developing countries – including by the Development Commissioner himself. During the past few years, and parallel to the preparation of the EU's Agenda for Change, the EU has considerably invested in new forms of and partners for cooperation beyond government and found a willing associate in the European Investment Bank (EIB).

5.1.1. Blending instruments

Whereas EU development cooperation in the past decade was often presented as having a high critical mass (see paragraph 52 of the European Consensus on Development), the 2012 Communication on Financing for Development showed a rather different understanding of the role of EU development cooperation: *"By far the biggest source of financing for development available to governments is the domestic revenue (…). Aid from development partners complements this, and can catalyse other flows, but is in itself not the major element for many developing countries."*[42]

The 2012 Communication moreover included a separate section on 'innovative financing sources'. While there is a broad commitment to the potential added value of innovative sources of finance, there is no consensus on the precise scope and nature of innovative financing – the only prerequisite for 'innovativeness' appears to be that such development financing cannot be fully or partly be reported to the OECD/DAC as Official Development Assistance. One typology that is used distinguishes three types of innovative finance in terms of their public or private sources and their public or private uses (Vanheukelom et al 2012):

1. **Public Private Partnership (PPP) mechanisms** use public funds to leverage or mobilise private finance to support public functions like infrastructure provision or service delivery (such as the complementary use of grants and loans, *frontloading of ODA*, raising funds on international capital markets by issuing bonds that are backed by long-term (legally binding) ODA commitments, and *Official Support for Private Flows* used to raise new revenues or to scale up or develop activities for development purposes).
2. **Solidarity mechanisms** that support public-to-public or sovereign-to-sovereign transfers of funds. This category includes global solidarity levies (i.e. taxes), but also covers debt conversions (or swaps). Under such debt-swap agreements, creditors agree to cancel a part of their claims on a debtor country in exchange for guarantees that a certain amount is spent on approved social or environmental programmes.
3. Finally the **catalytic mechanisms** use public finance for market creation and promoting private sector development by reducing risks of private entry. These mechanisms could assist private investment in production of traded goods and services by offering domestic currency loans, quasi-equity investment capital and guarantees. These include financial *guarantees*, *equity investments* and *callable capital*.

Out of these three types of approaches, the EU currently places particular emphasis on the first type, and the complementary use of grants and loans that is popularly referred to as 'blending'.[43] By doing so, blending allows sub-investment grade projects to become bankable and can therefore attract financiers to projects that would otherwise not have been realised (i.e. it creates leverage) (Núñez and Behrens 2011).

leadership at the 2008 Accra High Level Forum as well as in the elaboration of the EU Operational Framework on Aid Effectiveness. (Keijzer, 2011)

[42] See European Commisson (2012e)

[43] Blending instruments or investment facilities can be used for investments with a public character as well as for purely private investments, but tend to specialise in large-scale infrastructure investments, and most projects are of a public sector nature (European Think Tanks Groups 2011), and therefore they can be deemed a PPP mechanism.

There is some evidence that ODA can particularly play a catalyzing role in MICs with more stable and favourable economic climates in terms of 'crowding in' private investment (Glennie 2011). The leveraging potential of blending facilities is substantial, and a recent presentation of the European Commission during an informal session of the Council Working Party on Development Cooperation (CODEV) noted that since 2007 the investment of € 910 million of EU ODA grants had managed to unlock over € 30 billion of additional finances (grants, loans and investments) in developing countries (EC 2012b). Despite these significant leverage effects, such development financing currently goes unrecorded as they are not considered as ODA (Vanheukelom 2012).

In its 2012 peer review report of the European Union, the DAC concludes that blending instruments and private finance could help MICs to bridge funding gaps caused by the phasing out of ODA. Blending and private finance was also seen as adding to the EU's potential to engage strategically with MICs on global challenges. A recent study conducted for the European Parliament also detected a trend for EU bilateral donors whereby blending evolves into an instrument for investments in UMICs mainly, while grants in principle are provided for LICs and for interventions with a direct poverty reduction focus in MICs (Núñez et al 2012).

Many such claims have been put forward in recent presentations by the Commission, which together with the EIB is making strong efforts at communicating the overall policy intentions and overall financial volume generated by the seven EU blending facilities in which both institutions cooperate and which cover different regions in the world. These blending facilities currently mainly support public investment projects (92%) but also provide means to catalyse private investments. The EC has also recently sent a report to the Council and EP that describes details for setting up a EU Blending Platform to optimise the functioning of the blending facilities (EC 2012c). The report as submitted describes the objectives of this platform as *"to improve the quality and efficiency of EU development and external cooperation blending mechanisms, taking due account of the policy frameworks that govern the EU relations with the different partner countries, notably EU Development, Neighbourhood and Enlargement policies. This includes promoting cooperation and coordination between the EU, EIB and other relevant financial institutions (FIs) and other stakeholders"* (EC 2012c).

However, the proposed EU platform would not get evaluation responsibility, while the European Investment Bank (EIB) has an independent evaluation function but arguably performs poorly in this area compared to other International Financial Institutions with so far only 3 evaluations from 2011 and one from 2012 available on the Bank's website.[44] This points to a strong lack of evaluation efforts and empirical research more generally which is needed to find out more on how particularly the non-ODA components of blending operations would contribute to development in MICs (Vanheukelom et al 2012).

5.1.2. Non-ODA financial instruments

There are also non-ODA financial instruments of the EU's budget focused on external action that can support collaboration with MICs on global public goods, including:

- Funding mechanisms in the area of **research and innovation**. The EU recognizes that global challenges are important drivers for research and innovation and that the Union needs to strengthen its collaboration with international partners to join forces in this area (EC 2012). To step up efforts, the Commission has announced that the EU's new programme for research and innovation for the period 2014-2020 called 'Horizon 2020' with a proposed budget of €80 billion will have international cooperation as an important cross-cutting priority, which implies that it will cover targeted actions with key partner countries and regions.
- **Migration** represents another area of cooperation, with the Asylum and Migration Fund proposed for 2014 - 2020 as an important instrument, which includes, amongst other things, support measures for

[44] See http://www.eib.org/projects/evaluation/reports/operations/index.htm

returnees in the country of return in order to enhance their durable reintegration into their community. The proposal for the fund does indicate that *'Actions that are directly development oriented shall not be supported through this Fund'.*

- The field of **climate action and environment** is also increasingly key. The Commission has proposed to increase the proportion of the Union's budget related to climate action to at least 20% for the period 2014 – 2020, of which part can be dedicated to collaboration in this area with partners countries, regions and international institutions (EC 2011). This could include the Programme for the Environment and Climate Action (LIFE) and funds made available in the context of Fisheries Partnership Agreements.

In addition to these funding instruments, **political and policy dialogue** have proved vital to inform MICs – EU contributions to global public goods at national, regional and international level. The EU seeks to increasingly build strong alliances with individual and groups of MICs on issues of global concern, sometimes resulting in joint statements like the EU – India Joint Declaration on International Terrorism, with varying degrees of success.

5.2. Cohesion and integration

5.2.1. EU Cohesion Instruments

The EU's cohesion policy sought to achieve three overall objectives in the period 2007-2013[45]:

1. **Convergence – solidarity among regions:** Reducing regional disparities in Europe by helping those regions whose per capita gross domestic product (GDP) is less than 90% of the EU average.[46] Interventions are typically managed through projects on a range of areas such as improving basic infrastructure, helping businesses, water and waste treatment, high-speed internet connection, training, and job creation.
2. **Regional Competitiveness and Employment**: creating jobs by promoting competitiveness and making the regions concerned more attractive to businesses and investors. The type of projects funded include development of clean transport, support for research centres, universities, small businesses and start-ups, training, job creation, etc.
3. **European territorial cooperation**: encouraging cooperation across borders that would not happen without help from the cohesion policy. Interventions funded from a modest budget compared to the other two objectives include shared management of natural resources, risk protection, improving transport links, as well as creating networks of universities and research institutes.

The EU uses three structural and cohesion funds to achieve its Cohesion policy objectives: the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund. For the entire set of funds for the period 2014-2020, the Commission has proposed that the less developed regions receive 68,7% of the total funding, transition regions receive 11,6% and more developed receive 15,8%.

Whereas the ERDF concentrates funding on the less developed regions, the ESF provides relatively more funding for the transition and developed regions. The Commission also hopes to promote multi-fund programmes.[47] As the cohesion policy is implemented through 3 funds which each comprise several components, operating in over 1200 regions over a multi-annual period, during which time these regions

[45] See http://ec.europa.eu/regional_policy/how/index_en.cfm. Note that some changes to categorising countries have been proposed for the period 2014-2020, which would divide regions in one of three groups: (1) less developed, (2) transition or (3) more developed. What would remain is the GDP level as the key determining factor, but the tresholds and groupings are obviously subject to heated debate between Member States as part of the negotiations for the next EU budget. For more information refer to: http://ec.europa.eu/esf/main.jsp?catId=62&langId=en
[46] See http://ec.europa.eu/regional_policy/thefunds/cohesion/index_en.cfm
[47] See http://ec.europa.eu/esf/BlobServlet?docId=232&langId=en

move between the categories above, the management of the funds is a recurring challenge. The individual funds are described below.

The European Regional Development Fund (ERDF)

The ERDF is a financial instrument designed to correct imbalances in the level of development between the different regions of the EU in order to strengthen economic and social cohesion and contribute to the objectives of regional policy noted above. As such, the ERDF contributes to the financing of:

- investments contributing to the creation of sustainable jobs;
- investments in infrastructure;
- measures supporting regional and local development, including support and services for businesses (particularly small and medium-sized enterprises (SMEs));
- technical assistance measures.

Actions under this instrument are designed to reduce economic, environmental and social problems in urban and rural areas, with special treatment given to naturally disadvantaged areas (e.g. remote, mountainous or sparsely populated areas). Importantly, the EU's outermost areas benefit from specific assistance. The various regions are categorized according to an evolving system of classification based on the three objectives noted above.

Over the period 2000-2006, the ERDF is reported[48] as having contributed significantly to the development of the EU's transport infrastructure (e.g. motorways and railways) and to the creation of new jobs, thereby supporting the economic development of regions most in need. A large part of the funds are absorbed by cohesion projects, which were found to strengthen the conditions for longer-term sustainable development by enhancing environmental protection and reducing social disparities and territorial imbalances.

In terms of its support to disadvantages areas, a recent evaluation[49] notes that the instrument concentrates largely on 'hard' infrastructure (e.g. roads, ICT) and sectors drawing on natural assets of these areas (e.g. tourism, culture and natural resources), including the promotion of renewable energies. However, support to innovation and R&D projects remains low. It concludes that the ERDF is an appropriate instrument for the development of regions with specific features and characteristics, and can provide added value for regions affected by specific features, including through providing stable, long-term funding for projects which would otherwise not have been implemented, and in doing so attracting further funding for such projects.

The European Social Fund (ESF)

The ESF aims to improve employment opportunities, promote education and life-long learning, enhance social inclusion, contribute to combating poverty and develop institutional capacity of public administration in these areas with the objective of overcoming structural issues of EU labour markets.

Its funds are budgeted and disbursed to Member States, who manage and spend the funds themselves through their labour administration. As the amounts of funding are limited, actions funded by the ESF have been found to be most effective at the micro and meso levels, e.g. the modernization of systems such as national employment services, education and training systems. However, the ESF has also been found to add value to labour market coordination mechanisms and processes through the capacity development of labour administrations, indicating that it also has an impact on the policy (macro) level.[50]

Furthermore, the ESF has served to support active labour market policies in response to the Eurozone crisis at both national and regional level in the Member States. The principal interventions supported by the

[48] Applica et al (2010)
[49] ADE (2012)
[50] See LSE Enterprise et al (2010)

ESF were in the area of skills training and workplace activation, a traditional focus for the instrument. Member States were further able to tailor ESF spending to specific contexts, responding to the impact of the financial and economic crisis on specific sectors and adjusting to needs arising.[51]

The Cohesion Fund

The Cohesion Fund aims to contribute to the first objective and covers more than half of the EU Member States.[52] The Fund finances activities that fall in any of the following two categories:

- **Trans-European transport networks**, notably priority projects of European interest as identified by the Union;
- **Environment**; any energy or transport project as long as these present a benefit to the environment: energy efficiency, use of renewable energy, developing rail transport, strengthening public transport, etc.

The importance of successfully implementing such cohesion interventions should not be underestimated, since they are closely related to the core of the European project which is about providing for the long-term peace, prosperity and well-being of the citizens of its member states (Furness and Negre 2012). Some efforts have been made in the past few years to analyse to what extent the structural and cohesion funds and the wider cohesion policy have made a difference in this respect.

A recent analysis concludes that structural and cohesion funds have reduced within-country regional disparities over the period 1995-2006, and that beyond some level of transfer intensity (approximately 1.5% of country GDP), the positive impact is potentially reversed. Reasons for this may range from moral hazard and substitution effects to diminishing returns (Kyriacou and Roca-Sagalés 2012). Although it may have had such effects on in-country inequality, another analysis of structural and cohesion funds as received by Spain, Portugal, Greece and Ireland concludes that there is a lack of evidence to conclude to what extent structural and cohesion funds as 'countervailing policies' have improved regional cohesion (Bouvet 2010).

Another analysis by the European Central Bank concludes that EU structural and cohesion funds spent during 1994-1999 had a positive, but slight, impact on future economic growth, mainly through the human development component (Checherita-Westphal et al 2009). This seems to be supported by the case of Ireland, which prioritized investment in human resources, education and training by allocating up to 35% of its Structural Funds to human resource investments (against an average of around 25% for other cohesion countries) which is believe to have strongly contributed to the country's strong period of economic growth after having joined the Union[53].

Despite these important achievements made, a recent synthesis study published by DG Research concludes that socio-economic inequalities have increased in the EU and are higher today than they were in 1980. The study further notes pattern of modernisation at the expense of socio-economic cohesion is contrary to the values and objectives of EU policies and thus strongly argues for the implementation of the Europe 2020 Strategy that seeks to transform the EU's economy to one that promotes inclusive and sustainable development (Perrons 2011). The findings of this report suggest that countervailing policies cannot redirect patterns of growth and development if the overall policy direction does not promote inclusive and sustainable development, a finding not unlike the emerging lessons on how EU development cooperation can engage in MICs.

[51] See Metis (2012)
[52] Bulgaria, Cyprus, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia and Slovenia. Spain is eligible to a phase-out fund only as its GNI per inhabitant is less than the average of the EU-15.
[53] See http://www.iro.ie/EU-structural-funds.html

5.2.2. EU Neighbourhood Policy

The Council Regulation 1638/2006 from 24 October 2006 lays down the provisions for the establishment of the European Neighborhood and Partnership Instrument (ENPI), which serves to implement the European Neighborhood Policy (ENP). The EU Member States explicitly motivate the ENPI as a means to further the relations with the European neighbours based on shared political and economic values and contribute to avoid new dividing lines in Europe and promote stability and prosperity within and beyond the new EU borders (Mackie et al 2011). In 2004, the Council reiterated the importance of cooperation with neighbours on the basis of partnership, joint ownership and respect of shared values (democracy, human rights).[54]

A review of 15 evaluations that could be related to the ENPI Regulation concluded that EC interventions had made positive contributions to the development of trade relationships between the EU and the ENPI partner countries, and in supporting the development of the private sector – both important foci of EU development cooperation under the present EU Agenda for Change. Some positive results related to civil society were also identified as well as in the water and social sectors. It was found that on balance the interventions particularly contributed to one overall objective of the Instrument, namely the promotion of commitments to EU values (Mackie et al 2011).

Whereas low levels of ownership have been found to have hampered the effects and effectiveness of past interventions (Mackie et al 2011), it is widely believed that the ENPI's relatively normative approach as well as the assumed joint interest between the EU and the Neighbourhood countries (i.e. improving cooperation and for a few of them possible prospects of future EU membership) are key to the instrument's success.

The ENPI furthermore includes facilities for 'twinning' and targeted technical assistance (although these instruments are also accessible to (pre-)accession countries). The former is a tool for cooperation which links public administrations from EU Member States with those of partner countries (e.g. potential accession candidate countries and those covered by the ENPI) in order to resolve structural governance problems. Projects under the **Institutional Twinning Instrument** set out to deliver highly specific results based on detailed work programmes. While at times narrow, this rigorous approach to cooperation has led the instrument to be considered a modern, highly effective instrument which contributed to institutional capacity building, civil service modernization and legal approximation and harmonization of accession candidates. A recent evaluation notes that this is to some degee dependent on the feasibility of the objectives and the partner country's institutional capacity and legal framework.[55]

The Technical Assistance and Information-Exchange instrument (**TAIEX**) is a demand-driven tool that provides rapid tailor-made technical assistance from a pool of experts to support Neighbourhood countries and (pre-)accession candidate countries in the approximation, application and enforcement of EU legislation. Being demand-driven, no clear vision or strategy underpins the tool – it's usage and ownership stretches only as far as the EU enlargement policy. Activity reports show that countries eligible for accession are the most frequent users of the tool.[56] That is not to say the 'clearing house' format of the tool cannot be replicated to other policy areas with great effect.[57] Users of TAIEX have found it to be a useful complement to longer-term instruments such as twinning, and appreciated the rapid response to small

[54] The ENPI Council Regulation replaces the Regulation E1762/92 (Mediterranean non-EU members, June 1992), the Regulation 1734/94 (Gaza and West Bank, July 1994), the Regulation 1488/96 (so called MEDA, July 1996). It also replaces the Regulation 99/2000 (so-called TACIS, eastern Europe and Central Asia, December 1999) that expired in December (Mackie et al 2011).

[55] See HTSPE (2012)

[56] See European Commission (2012f)

[57] Indeed, the basic format for TAIEX is currently serving as the basis for the development of an Expert Facility for Social Protection, which aims to improve the capacity of government agencies of partner governments of the EU to design effective social protection systems, improve existing policies and programmes and extend their coverage. See European Commission (2012g)

obstacles provided by the tool. TAIEX was furthermore found to contribute to the efficiency of the accession process, specifically the implementation and enforcement of EU legislation.[58]

Despite the fact that the structural and cohesion funds do not get good press alone, and Europe has created its own share of 'white elephants' in the process, the policy is recognized as important for strengthening socio-economic cohesion in the Union, and for instance has helped Member States such as Ireland and Spain avoid the aforementioned middle-income-trap.

5.3. Peace and security operations

Peace and security are essential conditions for individual dignity and the development of prosperity and wellbeing in and between societies – there is also a clear EU interest in and commitment to promoting peace and security. The lack of stability in conflict areas, of which many are found in MICs as observed in section 3.2, affects security in the Europe in many ways. International criminal organisations often operate from unstable countries and regions, and conflicts often generate large migration flows. The Arab Spring was furthermore a wake up call to the supposed stability of MICs in the EU's own Neighbourhood. Global peace, security and the legal order are of great importance to security and prosperity in the EU, the protection of human rights and achievement of the MDGs.

Safeguarding peace and security and creating the conditions for effective and sustainable poverty reduction calls for a coherent approach to the underlying causes of violence and insecurity. This requires effective international cooperation and in many parts of the world the EU seeks to give shape to this through a so-called 3D approach (defence, diplomacy and development) (Ministerie van Buitenlandse Zaken 2011). As noted in section 4.3, the development and application of a comprehensive or integrated approach is a priority and the added value of the EU's engagement in conflict prevention and peace-building.

One of the successful deployments of this integrated approach in a MIC was in Indonesia (Aceh) where the EU brought together multi-level diplomatic mediation, a civilian European Security Defence Policy peace and security mission as well as development and humanitarian action. The diversity of interventions was appreciated and acknowledged by Indonesian stakeholders involved. The EU has also been a welcome if more discrete player in the peace process in the Philippines (Mindanao) where it again brought together humanitarian and development instruments with direct support to the peace process through the Instrument for Stability.

The EU institutions have seen a steady increase in financial commitments towards conflict prevention and peace-building for the period 2001-2010. For that period, commitments totaled at €7.7 billion, which makes up almost 10% of total ODA spending. The majority of these commitments went towards MICs such as West Bank/Gaza, Iraq, Sudan, Angola, Colombia, Sri Lanka, Lebanon, Georgia and Indonesia. (ADE, 2011b). Many targeted diplomatic or civil society actions on conflict prevention and mediation are furthermore not expensive when compared to traditional development interventions. The EU has also invested in increasing its capacities to engage in mediation and peace-building in partner countries.

In recognition of the fact that the EU's external action policies and instruments could not adequately respond to crises rapidly (despite having rapid response mechanisms in place), the Instrument for Stability (IfS) was created in 2006. The instrument has been found to enable EU Delegations to more readily support conflict prevention and peace-building processes, and has moreover stimulated reflection on programming priorities with a view on how conflicts can be prevented. Notably, the IfS contributed to an

[58] See MWH Consortium (2007)

improved exchange of information on conflict prevention and peace-building between Brussels and EU Delegations as well as among different Directorate Generals of the European Commission (ADE 2011).

Despite these strong achievements, independent analysis notes that the EU has been too focused on rapid response and short-term actions through the IfS, whereas it could better contribute to its objectives if efforts where made to better promote and mainstream conflict prevention and peace-building in other EU instruments and actions. (Görtz and Sherriff 2012).

The EU has furthermore launched a number of ESDP / CSDP missions since 2003 at the invitation of the host government. Table 6 shows the MICs in which missions have taken place, demonstrating that there has been and still is a demand for EU security interventions. However, there has been some criticism of the strategic relevance and impact of these missions – several of them do not have the necessary scale to lead to sustainable security, and can be interpreted as political statements rather than full-scale interventions. Lastly, the EU has appointed Special Representatives in countries and regions it deems of particular strategic interest, where there is a need for a coherent EU approach.

Table 6: EU ESDP/CSDP Missions and EU Special Representatives (EUSRs) in Middle Income Countries

MIC country/region	Current Mission	Past Mission	Current EUSR	Past EUSR
Bosnia and Herzegovina		X	X	X
Central Asia			X	
Georgia	X	X	X	X
Indonesia-Aceh		X		
Iraq	X			
Kosovo	X			X
Macedonia		X		
Moldova	X			X
Pakistan (with Afghanistan)				X
Palestinian Territories	X	X	X	X
South Caucasus			X*	X
South East Europe				X
Sudan**		X		
Ukraine	X			

* Combined with Georgia in 2011
** support mission to African Union mission

Current multilateral cooperation in the field of peace and security can be further improved. There are no clear goals for international action and in many situations there is insufficient leadership, coordination and capacity. There is a strong need to pursue closer alignment between the actions of EU institutions and member states in the areas of security and development (Ministerie van Buitenlandse Zaken 2011). In this regard, the clarification and realization of the EU's 'comprehensive approach' should be a priority – the approach purports to integrate and jointly operationalize the EU's various foreign policy instruments in specific situations. Many questions on what the concept entails are however still left unanswered, and there is a risk that the comprehensive approach will be too wide to be meaningful, or so narrow (such as structured only around CSDP missions) that it fails to fully exploit the EU's potential added value (Sherriff 2013).

5.4. Strategic Partnerships

Along with the Member State governments, the EU is also sensitive to the fact that MICs are developing into credible strategic partners in areas such as trade, security and energy. The concept of strategic partnerships first emerged in the 1990s and was described in the 2003 European Security Strategy as partnerships concluded with countries which share norms and values with the EU with the aim of strengthening 'effective multilateralism'. This approach has been confirmed in the Lisbon Treaty, which indicates that the EU will seek to build partnerships with third countries which share the EU's principles of democracy, rule of law, human rights and fundamental freedoms, human dignity, equality and solidarity. Not long after the entry into force of the Lisbon Treaty, the new High Representative Ashton announced a number of priorities for her term in office, which included the EU's relations with strategic partners (Van Seters and Klavert, 2011).

The EU has thus far concluded so-called 'strategic partnerships' with a group of countries that include a number of MICs including Brazil, China, India, Mexico, Russia and South Africa. Furthermore, the EU is considering establishing such partnerships with other MICs, notably Egypt, Indonesia and Pakistan. Regional strategic partnerships have been concluded with Africa and Latin America and the Caribbean, covering additional MICs.

The partnerships are comprehensive agreements covering a broad range of areas of cooperation. To illustrate, the EU – China Strategic Partnership includes development cooperation, trade, security matters and international challenges such as climate change and global economic governance. The EU and its strategic partnerships hold annual summits, regular high level dialogues and sectoral dialogues at expert level.

However, since the very beginning, the approach has suffered from a lack of clarity about the definition of the concept and its objectives, and an ad hoc selection of partners. While EU leaders promote such partnerships as being based on shared values and principles, strategic partnerships such as the ones with China and Russia cast doubt on this. Furthermore, shared values do not necessarily mean that partners' policy priorities will overlap (Grevi & Khandekar 2011). For instance, the aforementioned MICs with whom the EU has signed strategic partnerships do not have the MDGs clearly embedded in their vision of development (Fenton 2008), and even open and structured dialogue will not lead to a shared position on certain issues (e.g. South Africa's position on the Syrian crisis and Iranian oil imports) (Helly, 2012).

Analysts have highlighted specific weaknesses of the partnerships, including: (1) the fact that not all partner countries are equally strategic; (2) lack of effective cooperation on strategic issues; (3) impact of the strategic partnership on the relations between the two parties is limited; (4) some partner countries don't consider the EU to be a strategic partner (Renard 2011). The common format for strategic partnerships, which revolve around annual summits and very select programmes, can also be said to not fully reflect the spirit and day-to-day realities of such partnerships. Overall, the deepest and most consistent cooperation within the strategic partnerships is taking place in the area of trade and economic matters – political and security considerations are at present mainly expressed in rhetoric rather than acted upon (Grevi and Khandekar 2011).

Strategic partnerships effectively form the infrastructure for political dialogue and subsequent joint action. For the MICs, development cooperation need not be the basis for this political dialogue – while development cooperation will in many cases feature in the partnership, it is most likely not the EU's primary strategic interest, nor that of the partners themselves. Strategic partnerships are built not only on choice but often also on necessity in the recognition that the EU cannot face certain global issues, provide certain global public goods or provide certain benefits for its citizens in isolation.

The strategic partnerships currently in place cover a range of broad issues of cooperation – they are flexible and multi-purpose tools that hold the potential to contribute to a more comprehensive and coherent approach towards MICs. In moving forward, the EU and its Member States, need to ensure that it delivers on this potential. This requires that the partnerships be used to proactively enhance the quality of political dialogue in order for the parties involved to effectively identify, negotiate and manage their interests and identify common ground. Political dialogue with the MICs can challenge the EU to demonstrate its added value beyond development cooperation, and bring new knowledge, policy frameworks and instruments to bear. A brief analysis of the EU's strategic partnership with South Africa below provides further insight into the value of such partnerships.

Annex III provides a summary overview of the instruments analysed and lessons learnt in this section.

6. Evolving relations with MICs in practice: the case of EU's partnership with South Africa

Following South Africa's democratic transition from apartheid, the new government was keen to profile itself as both an extraordinary nation which could function as an example for other African countries, and a 'normal' part of the international political and economic system. Eager to retain the positive momentum of this transition and capitalize on South Africa's potential leadership role in the region and on the continent, the EU quickly engaged in renewed negotiations on its aid and trade relations with South Africa, culminating in the 2000 Trade, Development and Cooperation Agreement (TDCA). (Olivier 2006).

Negotiating the TDCA proved lengthy, principally because differing perspectives and perceptions of both parties were brought into contrast. Whereas South Africa preferred to accede to the Lomé Convention and its trade provisions, the EU perceived South Africa as being atypical from the other ACP countries[59]. In addition, South African agriculture and textile exports were thought to impact EU trade, and the EU was anxious for its engagement with South Africa to provide the model for post-Lomé developmental strategies with ACP countries[60]. The EU therefore instead negotiated a particular free trade agreement with South Africa, de facto excluding it from 1) non-reciprocal trade preferences and 2) access to EDF resources (though South Africa did retain access to DCI funds). (Olivier 2006)

Among its broad objectives are the strengthening of dialogue between the two parties, supporting South Africa's social and economic transition, its economic integration in Southern Africa as well as the global economy, and expanding trade between the two parties. The agreement called for the liberalization of trade, leading South Africa to sacrifice approximately 36% of its import duties, in exchange for a gain of 7% in duty-free access to EU markets, with complete liberalization to be attained by 2012. South Africa stood more to lose given that the EU is its largest trading partner – equally, South Africa has long been the EU's largest trading partner in Africa, garnering just below 1.5% of the EU's trade volume (Grevi and Khandekar, 2011).

Whilst the TDCA was mainly based on the EU's terms, both parties nonetheless perceive the agreement to be beneficial - South Africa notably believed it acknowledged its special and privileged position compared to other African countries, and cooperation in trade and development was broadly successful in the last decade of the relationship. Yet the TDCA states the ambition to enhance regular political dialogue on

[59] South Africa's relative economic progress would mean its trade flows would have far outstripped those of other ACP countries.

[60] Other reasons offered for this choice include: the fact that the Lomé Convention was set to expire shortly; worsening tensions over the WTO compatability of the Lomé Convention; and full membership of the Lomé Convention might have slowed down the dismantling of South Africa's protectionist measures, providing disincentives to (EU) FDI

issues of common interest at both bilateral and regional level within the framework of the Southern African Customs Union (SACU) and the Southern African Development Community (SADC). While political dialogue was consistent throughout, it remained on the fringe. Though dialogue was instrumental in altering South Africa's policy on HIV/AIDS and peacekeeping efforts in the Great Lakes region, it has had very little influence on the situation in Zimbabwe, with both parties not effectively using their 'soft power'.

Subsequently, the 2007 Strategic Partnership[61] and accompanying Joint Action Plan[62] (complementing the TDCA, yet without having a legal basis) have reaffirmed these areas of cooperation, broadened the partnership to new areas of cooperation and endeavor to lift the partnership beyond the previous donor-recipient relations to a more interest-driven political and value-based partnership, reflecting South Africa's place among the BRICS countries. Some have noted that the EU engaged in the process so shortly after ratifying the TDCA as it needed to include an African country on its shortlist of potential candidates of strategic partners (Helly, 2012). Nonetheless, the partnership builds on the political dialogue commitment noted in the TDCA.

As noted in the partnership agreement, South Africa's priorities for (and thus perceived added value of) cooperation with the EU are trade, development finance, knowledge and technology exchange, diplomatic support and coordination in international fora and support to regional integration. The EU has prioritized trade and investments, cooperation on energy policy and regional public goods such as climate change, peace and security, good governance and international justice. In addition, science and technology is an important area of cooperation for both parties.

These priorities overlap in key areas of interest, notably the promotion of sustainable agriculture and space cooperation – these and several other areas of cooperation between the EU and South Africa predate the Strategic Partnership – the document therefore seeks to give structure to areas of mutual strategic interest where cooperation otherwise remained informal. Yet whereas the TDCA had a contractual legal basis, the implementation of the strategic partnership relies on the shared interest and goodwill of the two parties. The partnership therefore provides a clear illustration of the pursuit of interests beyond the rhetoric of shared values and principles.

The partnership is strongly shaped by the EU's perspective of South Africa's role on the African continent – it has long encouraged South Africa to take a leading role in the regional integration of southern Africa, and more recently has come to expect South Africa to lead the African Union and promote and drive the implementation of the Joint Africa-EU Strategy (JAES).[63] In contrast, South Africa is reluctant to ally its diplomatic weight to one partnership, and seeks to establish its presence through a multitude of alliances and partnerships including in regional (economic) communities (SADC), continental fora (the African Union) and South-South forms of cooperation such as the IBSA Dialogue. South Africa's post-apartheid foreign policy projects the image of a concerting actor, a bridge-builder with considerable 'soft power' derived from its position as moral example for peaceful and democratic reform on the continent (Sidiropoulos 2012).

While partnership is one of the broadest and most intensive of the EU's Strategic Partnerships, the EU is arguably not one of South Africa's closest friends and allies in multilateral negotiations. Differences of opinion between South Africa and the EU have manifested themselves on critical issues such as the human rights dialogues on Zimbabwe, climate change negotiations in Copenhagen and Durban and the international response to the crisis in Libya.

[61] See European Commission (2006)
[62] See Government of the Republic of South Africa (2007)
[63] See http://eeas.europa.eu/africa/continental/index_en.htm

Nonetheless, there is a mutual respect of the differences of opinion, which appear to have only a limited spillover effect on other areas of dialogue and cooperation. There remain political issues of mutual interest and reciprocal benefit – e.g. the EU wishes to exert influence in the AU whilst South Africa wishes EU support in attaining a permanent UNSC seat. (Grevi and Khandekar, 2011) However, South Africa must balance the strain of being, on the one hand, an African state, whilst also being an example for and representative of the continent in global fora and on the other hand furthering its own goals and interests. At times these interests are much close to those of other BRICS countries.

The dialogue and cooperation with the EU institutions is nonetheless frequent and effective, particularly in those areas which already saw comprehensive cooperation under the TDCA, including trade and development cooperation, but also those that have a longer track-record such as in peace and security, science and technology[64] and higher education. This is aided by the dedicated capacity in such areas at the EU Delegation in Pretoria and the Representation of South Africa in Brussels. Interest of both parties in these areas have a clear overlap – even if there is not always agreement, there is an appreciation of the parties' resources, value added, competences and roles both bilaterally and on the African continent. Furthermore, disagreements generally occur over implementation issues. Thematic dialogues noted in the Strategic Partnership have also shown results in areas which are less politically sensitive and comparatively well-resourced (such as Information and Communication Technology (ICT) or space collaboration), whereas other areas such as health, migration and energy have in the past shown less tangible progress.

Development cooperation remains a prominent part of the partnership, though the EU has been conscious of the limits of its added value since before the TDCA. The EC has pioneered its concept of the 'value added' approach to ODA in South Africa since 2007, acknowledging that the real value of development cooperation in this context does not arise from the amount of funding but rather targeted, jointly-identified initiatives with a high added value due to their emphasis on innovation, piloting and risk- taking, capacity development and different forms of skill- and knowledge-transfer.[65]

In parallel, the EU will engage in development cooperation with local NGOs and other CSOs to further democracy, governance, security and the rule of law, while also supporting South Africa's regional cooperation and integration. The government of South Africa should be able to replicate successful activities itself, and the approach therefore sees a shift from project-based aid to sector budget support.[66] The partnership also makes reference to South Africa's potential (growing) role as a bilateral aid donor and notes that the EU and South Africa will seek to engage in South-South forms of cooperation.[67]

The partnership is furthermore typified by close relationships between EU and South African technical or specialized agencies and organisations, notably the European Investment Bank (EIB), the Development Bank of South Africa and the Industrial Development Cooperation of South Africa. Indeed, it is at the technical level, involving technical specialists but also mid-level officials in policy areas such as social affairs and higher education, that value is added to the political dialogue by providing EU resources, expertise and knowledge lacking in South African line ministries.

[64] Cooperation in this area has been particularly strong in the context of the Square Kilometre Array project – EU research institutes played an integral part in the projects' conception, and the majority of EU Member States supported South Africa's tendering to host the array.
[65] See http://ec.europa.eu/europeaid/where/acp/country-cooperation/south-africa/south-africa_en.htm
[66] Early indications are that aid allocations to South Africa will diminish considerably for the 2014-2020 EU budget period.
[67] This will become more pressing following the recent establishment of the South African Development Partnership Agency (SADPA).

What both limits the achievement of the full potential of the partnership, while at the same time ensuring its peer-to-peer character in some instances, is the fact that there is not always a shared assessment on sensitive political issues. Furthermore, the Action Plan contains no concrete deliverables to drive cooperation further – this has left scope for long-term political strategy and vision to affect the direction of cooperation under the partnership (e.g. the EU pushing for South Africa to take up a leading role in the region). Slow progress in some areas of dialogue can lastly also affect other areas. Regardless of these flaws, the partnership is nevertheless considered a successful bilateral cooperation model.

The sound working arrangements have in part been ascribed to the establishment of a legal, institutionalized framework of cooperation and the normalization of diplomatic relations under the TDCA, combined with South Africa's special membership of the Cotonou Partnership Agreement. Well-functioning cooperation furthermore developed around subsequent, specialized agreements such as the Scientific Cooperation Agreement. (Olivier 2006)

Lastly, the Strategic Partnership has been supported by a Dialogue Facility[68], designed to support the partnership's political dialogue by providing technical assistance (expertise, research and other resources). While it is still too early to tell whether the Facility has succeeded in enhancing political dialogue between the two parties, it represents an operational 'middle-man' between them which could potentially support the clarification of mutual interests and opportunities and obstacles for engagement, as well as involve a broader set of stakeholders in the dialogue. Whereas it cannot substitute solid institutional arrangements or replace the institutional memory of the actors involved, it can serve as a useful complement.

7. Conclusions and recommendations for further (policy) discussion

The analysis of this paper has shown that the MICs share as least as many differences as they share similarities, and together represent both the largest part of the challenge and of the solution of global development. Furthermore, the changing geography of poverty and shifting balance of political and economic power mean that the EU and its Member States can no longer engage with MICs solely through traditional development cooperation.

The intention for new forms of cooperation with MICs is clearly reflected in the EU's current development cooperation policy. The EU is now faced with the challenge of determining tailor-made approaches towards engaging with MICs. This goes beyond a debate on whether countries should be entitled to a particular share of the presently debated EU ODA. More fundamentally, the EU is yet to seriously deal with the question of how to formulate and realise a holistic external action policy towards MICs, taking their diversity into account. This may be easier for the EU's Member States who, as bilateral donors and actors, can to a degree tailor their response on a country-by-country basis. Nonetheless it is in the interest of development effectiveness for Member States to seek complementarities and synergies between their policy and practice for cooperation with the MICs and that of the EU.

Several conclusions are drawn below, presented in the form of 'main messages' and practical recommendations to inform the EU Member States' policy discussions on the EU's future engagements with MICs.

[68] See http://www.dialoguefacility.org/

1. Clarify the purpose, nature and scope of the EU's engagement with MICs beyond traditional development cooperation.

The diversity of the MICs has three important implications for the discussion on how to engage with MICs. Firstly, the EU is often pursuing multiple interests (trade, security, energy) in these countries simultaneously, of which development may only be a minor consideration. Secondly the MICs themselves may look towards the EU for quite different things – ranging from market access, science and technology collaboration to security engagements in addition to support for addressing poverty. Third, appreciating both of these and the "political economy" underpinning them is a crucial starting point to ensuring the effective design and differentiated application of (tailor-made) foreign policy instruments. It would also ensure that the development dimension is not lost, even if the EU policy instruments used are different from conventional ODA and development policy dialogue. Political economy analysis can also provide a useful 'reality check' for what is within the realm of possibilities for achieving policy objectives.

Given the strategic interest involved in cooperating with the MICs, more politically infused analysis would benefit the clarity and specificity of policy frameworks and instruments. Clarity needs to prevail to ensure successful partnership, including agreement on shared interests and priorities that form the basis of the partnership. This has been well illustrated by the European Neighbourhood Partnership Instrument (ENPI), where the joint political analysis and identification of mutual interests between the EU and its neighbouring countries have proven key to the instrument's success. Conversely, well-designed frameworks supported by laudable principles on paper with little chance of delivering on their objectives in practice have in the past demonstrated the cost of EU external partnerships and dialogue not supported by political economy analysis (see Bossuyt and Sherriff, 2010). Mutually shared strategic interests should form the basis of further cooperation with the MICs.

Recommendation for EU Member States:

- EU Member States can contribute to forging mutually beneficial partnerships with the MICs by promoting and supporting the conduct and popularization of shared, political economy analysis to shape the EU's partnership with MICs beyond development cooperation. Such analysis should put the shared interests, priorities and added value of the two parties central, and help to define concrete and realistic deliverables for priority areas of cooperation.

2. Differentiate between and adopt tailor-made approaches for cooperation with MICs.

The analysis in this paper highlights that it is important to not only take income, but also other characteristics of MICs into account. The MICs are a heterogeneous group covering over half of the world's countries. The on-going discussions on how to differentiate between partner countries for EU development assistance should be conscious of this - there is a need to 'unpack' this group to ensure a tailor-made approach for the EUs cooperation with these countries, see Box 2.

Box 2: Examples of important sub-sets of countries with shared characteristics within the group of MIC's

The eight largest countries in the MIC category:

Nearly 80% of the world's poor live in the eight largest countries in the MICs category and they generally perform low in terms of environment health and ecosystem vitality, while due to their seize they potentially have an important role to play in the provision of global public goods. Given the relative low tax revenues of the 'big 8', ODA can potentially play a valuable albeit minor, indirect role in strengthening domestic resources mobilization, policies and programmes for income redistribution.

Fragile states and countries in a fragile situation:

The group of MICs, particularly LMICs, contains many countries in fragile situations where large numbers of people live close to the poverty threshold. Several of these countries are particular strategic interest to the EU - a comprehensive approach to conflict prevention and support to the restoration of security, state sovereignty and legitimacy as well as poverty reduction could be a priority for the EU's engagement with these countries. This should be realised through a context specific and adaptive approach reflecting on past lessons and experience.

Vulnerable economies:

Among the MICs are some of the world's most economically vulnerable countries. Small-Island Developing States and land-locked countries are particularly vulnerable, but a wider group suffers from the middle-income trap caused by slow or unsuccessful economic transformation, regardless of high levels of growth. The EU could support these countries in ensuring sustainable and inclusive development by reducing their vulnerabilities to the extent possible and ensuring that economic growth also benefits the poor in the short and long run.

Furthermore, the diminishing relevance of ODA (globally and specifically in the MICs) means that development cooperation cannot provide a solid foundation for cooperation with the MICs. ODA can however continue to play a relevant supporting role. In most MIC (apart from the 'big 8' where ODA amounts are negligible) ODA should particularly be used to incentivize and catalyse change in clearly identified issues. Thematic instruments (such as the EIDHR, IfS, DCI programmes) concentrating on global public goods and challenges will continue to add value for the MICs in this regard. ODA can furthermore usefully play a role of mobilizing additional sources of development finance, including domestic resource mobilization and leveraging private sector finance through blending mechanisms with a clear poverty reduction objective.

Recommendations for EU Member States:

- EU Member States will benefit from an active dialogue on how to reshape existing modalities for ODA in order to address key issues facing the MICs. For example, research efforts are required to evaluate the risk and impact of the non-ODA component of blending instruments, and (continued) research needs to assess different aid modalities in promoting effective domestic resource mobilization. In finding a new role for ODA, EU Member States should endeavor to agree on country-specific configurations of aid modalities.
- EU Member States should continue to financially and politically support those EU instruments which target specific issues and vulnerabilities relevant to MICs. This particularly applies to comparatively 'smaller' aid instruments, such as the African Peace Facility and the Instrument for Stability, that support the creation of the conditions for poverty reduction in MICs.

3. Draw on the EU's track record more systematically to integrate lessons learnt from cooperation with MICs in different regions and using different (non-ODA) instruments.

The EU's cooperation with the MICs should be informed by its comparative advantages, e.g. its broad and deep toolbox of instruments and the potential for learning and increasing impact that his affords to new partnerships. While the EU's Agenda for Change is ambitious, but also largely 'terra incognita' when it comes to the ambition of promoting inclusive and sustainable growth and development - the need to look for and develop new instrument and partnerships is accordingly recognized.

The analysis in this paper points at interesting innovations in different areas, notably in the EU's neighbourhood as well as inside the EU's own disadvantaged regions, which can provide useful direction to the EU's engagement in MICs. Notably, the EU's experience in promoting equitable regional integration with support of structural and cohesion funds offers a notable source for new ideas and significant amounts of learning for cooperation with MICs.

Many financial instruments proposed for the period 2014 – 2020 can potentially play a role, such as the Partnership Instrument for collaboration on global public goods, Horizon 2020 in the area of research and innovation, the Migration Fund and climate financing. Furthermore, in adapting and applying ODA instruments to catalyse change in key areas, there is a stronger need for evaluation and knowledge sharing, also drawing from EU Member States' experiences, on how non-ODA policies and instruments operate and affect developing countries, particularly when public funds linked to the Union's development objectives are used to facilitate private EU investment in developing countries. An informal taskforce of EU officials from different DGs could engage in such a 'systemization' exercise and put forward key recommendations for the EU's engagement in MICs to the European Council and Parliament.

However, successful cooperation with MICs should not be structured (only) around funding. Robust political and policy dialogues in a variety of areas are at the heart of successful partnerships between the EU and MICs. Specific cooperation agreements with individual countries (such as the strategic partnership agreements) have great potential to frame such cooperation, and can be developed to proactively enhance the depth and quality of political dialogue between the EU and the MICs.

Recommendations for EU Member States:

- To inform the development of new modalities as well as the improvement of existing mechanisms at the EU level, Member States can capture and share their experiences of bilateral cooperation with MICs.

- Conversely, EU Member States can learn valuable lessons from assessing the full package of the EU's external action and internal instruments in ongoing discussions to reform their bilateral or joint cooperation efforts with MICs. Specific instruments can be used to target particular issues in MICs – for instance, lessons can be learnt from the use of the EU's cohesion instruments in reducing inter-regional (income) disparities (thus promoting equitable regional integration) within MICs. Annex III can serve as a useful reference in this regard. EU Member States can achieve 'quick wins' by actively making use of or replicating existing EU tools for cooperating with MICs that have proven their effectiveness. Notably, the Institutional Twinning and TAIEX instruments fulfill practical needs that can enhance the day-to-day cooperation with MICs.

- EU Member States would benefit from aligning their bilateral political dialogue with those MICs with which there is a Strategic Partnership in place at the EU level to its stated priorities and objectives. For 'smaller' Member States, such partnerships are an effective vehicle for political dialogue to influence MICs' policies – this is particularly relevant given that several EU Member States have put human rights at the center of their development policy, yet have limited capacity to effectively promote human rights in MICs. While it is not desirable for either party to discontinue bilateral engagements between Member States and MICs, efforts should be made to ensure that such bilateral engagements do not precede or undermine the Strategic Partnerships.

Annex I: Comparison of OECD and World Bank Middle-Income Country classifications

OECD DAC List of ODA Recipients (January 2012)		**World Bank Country and Lending Groups (July 2012)**	
Lower-middle-income countries and territories ($ 1,006 - 3,975 in 2010 per capita GNI USD)	Upper-middle-income countries and territories ($ 3,976 - 12,275 in 2010 per capita GNI USD)	Lower-middle-income economies ($ 1,026 - 4,035 in 2011 GNI USD)	Upper-middle-income economies ($ 4,036 to 12,475 in 2011 GNI USD)
Armenia	Albania	Albania	Angola
Belize	Algeria	Armenia	Algeria
Bolivia	* Anguilla	Belize	American Samoa
Cameroon	Antigua & Barbuda	Bhutan	Antigua and Barbuda
Cape Verde	Argentina	Bolivia	Argentina
Republic of Congo	Azerbaijan	Cameroon	Azerbaijan
Côte d'Ivoire	Belarus	Cape Verde	Belarus
Egypt	Bosnia & Herzegovina	Congo, Rep.	Bosnia and Herzegovina
El Salvador	Botswana	Côte d'Ivoire	Botswana
Fiji	Brazil	Djibouti	Brazil
Georgia	Chile	Egypt, Arab Rep.	Bulgaria
Ghana	China	El Salvador	Chile
Guatemala	Colombia	Fiji	China
Guyana	Cook Islands	Georgia	Colombia
Honduras	Costa Rica	Ghana	Costa Rica
India	Cuba	Guatemala	Cuba
Indonesia	Dominica	Guyana	Dominica
Iraq	Dominican Republic	Honduras	Dominican Republic
Kosovo	Ecuador	Indonesia	Ecuador
Marshall Islands	FYR Macedonia	India	Gabon
Micronesia	Gabon	Iraq	Grenada
Moldova	Grenada	Kiribati	Iran, Islamic Rep.
Mongolia	Iran	Kosovo	Jamaica
Morocco	Jamaica	Lao PDR	Jordan
Nicaragua	Jordan	Lesotho	Kazakhstan
Nigeria	Kazakhstan	Marshall Islands	Latvia
Pakistan	Lebanon	Micronesia, Fed. Sts.	Lebanon
Papua New Guinea	Libya	Moldova	Libya
Paraguay	Malaysia	Mongolia	Lithuania
Philippines	Maldives	Morocco	Macedonia, FYR
Sri Lanka	Mauritius	Nicaragua	Malaysia
Swaziland	Mexico	Nigeria	Maldives
Syria	Montenegro	Pakistan	Mauritius
* Tokelau	*Montserrat	Papua New Guinea	Mexico
Tonga	Namibia	Paraguay	Montenegro
Turkmenistan	Nauru	Philippines	Namibia
Ukraine	Niue	Samoa	Palau
Uzbekistan	Palau	São Tomé and Principe	Panama
Vietnam	Panama	Senegal	Peru
West Bank & Gaza Strip	Peru	Solomon Islands	Romania

	Serbia	South Sudan	Russian Federation
	Seychelles	Sri Lanka	Serbia
	South Africa	Sudan	Seychelles
	* St.Helena	Swaziland	South Africa
	St. Kitts-Nevis	Syrian Arab Republic	St. Lucia
	St. Lucia	Timor-Leste	St. Vincent and the Grenadines
	St. Vincent & the Grenadines	Tonga	Suriname
	Suriname	Ukraine	Thailand
	Thailand	Uzbekistan	Tunisia
	Tunisia	Vanuatu	Turkey
	Turkey	Vietnam	Turkmenistan
	Uruguay	West Bank and Gaza	Tuvalu
	Venezuela	Yemen, Rep.	Uruguay
	* Wallis & Futuna	Zambia	Venezuela, RB
40	54	54	54
94		108	

* Territory

While not very different, the two methodologies vary in three key aspects. First, the OECD classification is not related to membership or other entry criteria, while the World Bank classification only includes WB member countries and economies with more than 30,000 inhabitants. The two lists are therefore composed for different purposes - the OECD list is the reference list for statistical reporting eligibility on official development assistance (ODA), while the World Bank list determines eligibility for International Development Association (IDA) loans and grants[69] in general as well as for specific forms of loans.[70] Second, the OECD classification also incorporates the United Nations list of Least Developed Countries (LDCs) that, together with the donor-driven function of the list, lends the OECD classification a rather ODA-centric character. 16 MICs are also LDCs. Third, the OECD list is revised once every three years, whereas the World Bank list is updated every year in July and is therefore more up-to-date.

[69] IDA is the World Bank's branch providing loans and grants on concessional terms, primarily to low-income countries.
[70] The World Bank list's basis as an aid allocation criterion is not without criticism, see notably: Ravallion (2012).

Annex II: Summary overview of key issues facing Middle-Income Countries

Issue / Constraint	Possible indicator(s)	Particularity for MICs	Examples
Fragile states and situations			
Recent or on-going conflicts or other security concerns	Fragile state classification; World Governance Indicators (WGI) – political stability, absence of violence, terrorism; Post-conflict classification; Presence of peace-building or peace-keeping missions.	Several countries have emerged from conflict into the MICs category. MIC-status dependent on achieving stability.	Sudan, Iraq, Timor-Leste, Egypt, Colombia, Bosnia, Guatemala, Tajikistan.
Low capacity for basic service delivery and good governance	Debt service as % of GDP; WGI – government effectiveness, control of corruption.	Donor engagement touches upon sovereign policy areas in which certain MICs could in theory effectively deliver.	Sudan, Iraq, Cote d'Ivoire, Laos.
Low state legitimacy, restricted political freedoms	Perception of corruption; WGI – regulatory quality, rule of law, voice and accountability.	Lack of legitimacy often coupled to low political will, which make traditional forms of development cooperation weak instruments for engaging with such countries.	Turkmenistan, Belarus, Cameroon, Ecuador.
Income inequality			
Unequally distributed income gains (high income inequality)	Gini coefficient; Share of GNI earned by top decile as percentage of share of GNI earned by bottom four deciles.	Higher risk of social and political instability. Donor engagement touches upon sovereign policy areas. Estimated cost of ending poverty is lower than for LICs, though necessary marginal tax rate can be unrealistic (>50%).	Brazil, El Salvador, Angola, Nigeria.
Middle income trap			
Traditional economic structure, lack of economic dynamism and diversification	GDP generated by non-agricultural sectors (% of GDP); Investment as % of GDP; Investment in consumer goods or other capital-intensive sectors as % of total investment; R&D spending and other spending on innovative technologies as % of total investment; GDP per person employed (PPP).	Lays conditions for the 'middle income trap'.	Bolivia, Cameroon, Senegal, Turkmenistan, Zambia.
Trade dependence, including on the export of natural resources	Trade volume as % of GDP; Natural resource rents as % of GDP.	Lays conditions for the 'middle-income trap', as well as the Dutch Disease.	Angola, Republic of Congo, Turkmenistan.
Dependency on natural resources (export concentration)	Natural resource rents as % of GDP; Exports of primary commodities as % of GDP.	Lays conditions for the 'middle income trap', as capacity to transform economy is limited.	Angola, Azerbaijan, Republic of Congo, Ghana, Turkmenistan, Zambia.
Restricted access to investment capital	Institutional Investor Rating; Gross fixed capital formation as % of GDP; External debt as % of	Lays conditions for the 'middle income trap', as capacity to transform economy is limited.	Swaziland, Yemen.

	GDP.		
Environmental and economic vulnerability			
Environmental conservation and preservation	Environmental Performance Index	Direct effects on global public goods.	India, Kazakhstan, Yemen, South Africa, Turkmenistan, Iraq.
Geographic constraints	Landlocked country status Small Island Development States	Specific sets of fragilities and economic vulnerabilities facing regionalised clusters of countries point towards the necessity for a regional approach.	Kazakhstan, Mongolia, Uzbekistan, Turkmenistan, SIDS.

Source: own analysis.

Annex III: Summary overview of (non-)ODA instruments and modalities for engaging with MICs

Instrument	MICs targeted	Objectives	Lessons Learnt
Innovative forms of development finance	Potentially all.	Provide alternative sources of revenues and financing for development to ODA, in part supported by ODA.	Blending facilities hold significant potential for leveraging private sector funding and bridging funding gaps from decreasing ODA; ODA can play a catalyzing role in MICs with more stable and favourable economic climates by ‘crowding in’ private investment; Commonly used in UMICs.
Cohesion instruments	UMIC Member States: Bulgaria, Latvia, Lithuania, Romania and disadvantaged regions (rural areas, areas affected by industrial transition and regions which suffer from natural or demographic handicaps).	Reducing regional disparities in Europe; Creating jobs by promoting competitiveness and the business / investment climate; Encouraging cooperation across borders.	ERDF: Significant contribution to infrastructure, ICT, tourism, culture and natural resources and renewable energies, levering further projects. Cohesion Funds: Effective at reducing intra-national regional disparities if transfers kept at < 1.5% of national GDP; ESF: Micro- and meso-level projects found to be most effective (e.g. modernisation of national employment services). Adds value to labour market coordination mechanisms. MS management means the instrument is adaptable to specific contexts.
Neighbourhood funding	EU Neighbourhood countries: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, the Republic of Moldova, Morocco, the Occupied Palestinian Territories, Syria, Tunisia and Ukraine	Support the progress towards democracy and sustainable economic and social development based on EU principles; Promotes regional integration and partnerships such as EuroMed and the Union of the Mediterranean.	ENPI: Interventions contribute to the promotion of EU values and principles in the Neighbourhood. Low ownership is a risk – improved cooperation based on joint interests, including the possibility of EU accession, can increase ownership. Twinning: highly specific results and work planning strongly increase impact of interventions. Results to a degree depend on partners’ capacity and legal framework, feasibility of objectives. TAIEX: effective and efficient rapid response ‘clearing house’ tool to support longer-term instruments and processes.
Peace and security interventions	Fragile states, Conflict-affected countries, strategic countries with fragile situations.	Promote peace and structural stability, prevent conflict and manage crises.	Diverse interventions, bringing together multi-level diplomatic mediation, civilian peace and security operations, development and humanitarian interventions valued by partner countries; All instrument relevant but also IfS enables reflection, dialogue and more ready short-term support to conflict prevention and peace-building, yet little long-term vision and mainstreaming of conflict prevention and peace-building in other EU instruments CSDP missions need critical mass to lead to sustainable security;

			EU coordination and capacity for joint international action needs to be improved, with clearer goals and leadership.
Strategic Partnerships	Brazil, China, India, Mexico, Russia, South Africa.	Commit to and implement joint action in areas of mutual interest; Strengthen effective multilateralism; Promote principles of democracy, rule of law, human rights and fundamental freedoms, human dignity, equality and solidarity.	Flexible, multi-purpose tool that can be used to strengthen the quality of political dialogue; Lack of clarity on the definition and concepts of partnership objectives and ad-hoc selection of partners on does not lend partnerships credibility. Partnerships should be based on stated interest, as values and principles are too mutable. Annual Summit-format of partnerships does not reflect day-to-day nature and necessities of strategic partnership.

Source: own analysis.

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About ECDPM

ECDPM was established in 1986 as an independent foundation to improve European cooperation with the group of African, Caribbean and Pacific countries (ACP). Its main goal today is to broker effective partnerships between the European Union and the developing world, especially Africa. ECDPM promotes inclusive forms of development and cooperates with public and private sector organisations to better manage international relations. It also supports the reform of policies and institutions in both Europe and the developing world. One of ECDPM's key strengths is its extensive network of relations in developing countries, including emerging economies. Among its partners are multilateral institutions, international centres of excellence and a broad range of state and non-state organisations.

Thematic priorities

ECDPM organises its work around four themes:

- Reconciling values and interests in the external action of the EU and other international players
- Promoting economic governance and trade for inclusive and sustainable growth
- Supporting societal dynamics of change related to democracy and governance in developing countries, particularly Africa
- Addressing food security as a global public good through information and support to regional integration, markets and agriculture

Approach

ECDPM is a "think and do tank". It links policies and practice using a mix of roles and methods. ECDPM organises and facilitates policy dialogues, provides tailor-made analysis and advice, participates in South-North networks and does policy-oriented research with partners from the South.

ECDPM also assists with the implementation of policies and has a strong track record in evaluating policy impact. ECDPM's activities are largely designed to support institutions in the developing world to define their own agendas. ECDPM brings a frank and independent perspective to its activities, entering partnerships with an open mind and a clear focus on results.

For more information please visit www.ecdpm.org

ECDPM Discussion Papers

ECDPM Discussion Papers present initial findings of work-in-progress at the Centre to facilitate meaningful and substantive exchange on key policy questions. The aim is to stimulate broader reflection and informed debate on EU external action, with a focus on relations with countries in the South.

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