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AID TO THE POOR IN MIDDLE INCOME COUNTRIES AND THE FUTURE OF IDA

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Abstract

We are sleep walking into a situation where over the next decade and a half concessional development assistance will disengage from the bulk of the world's poor. This is happening because countries that are graduating into Middle Income status still have large numbers of poor people. This new situation, where three quarters of the world's poor live in Middle income Countries, raises fundamental questions about the salience of national level achievements in determining global responsibilities toward the poor in each nation. They also raise basic questions for the operational rules of access to concessional development assistance such as that provided by IDA. This paper sets out the issues, and presents a proposal for a new window of IDA which recognizes that poverty persists and development problems remain despite the welcome graduation of many countries to Middle Income status.

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1. Introduction

The ongoing shift of global economic weight to "developing countries" has been much remarked upon. The transformation of previously Low Income Countries (LICs) to Middle income Countries (MICs) has accelerated in the last twenty years. China graduated in the late 1990s. Indonesia, India, Vietnam, Ghana are the latest countries to cross the threshold. Relatedly of course, there has been a shift in geopolitics. We have gone from G7 to G8 to G20. A grouping like BRICS has a global salience which it could not possibly have had two decades ago. India's quest for a permanent seat at the UN Security Council is no longer seen as quixotic, and indeed the claims of other emerging economic powers like Brazil are treated seriously.

However, despite all this, consider the following stunning stylized fact. Using standard official definitions, twenty years ago 90% of the world's poor lived in LICs. Today, three quarters of the world's poor live in MICs (Sumner, 2010). At one level this could be dismissed as nothing more than a cute observation—a matter of classification and nomenclature. But it matters. It matters because so much of our framing and thinking about global responsibility for the poor is cast in national terms. And this is manifested concretely in the operational rules of concessional development assistance. While there are variations and gradations, such assistance basically stops when a country crosses the threshold to MIC status, irrespective of how many poor still remain in the country, and how poor they are in income and non-income dimensions.

The new global realities mean that if the current rules of access are not changed then over the next decade or so concessional development assistance will gradually disengage from the vast bulk of the world's poor. This is not an outcome to be taken lightly. It needs to be discussed and debated by analysts, the moral obligations clarified and the operational implications of continued engagement (or disengagement) developed as policy options. This paper is a contribution to such rethinking, which is now underway in LICs, MICs and in development agencies.

The plan of the paper is as follows: Section 2 outlines of the evolution of the engagement of concessional development assistance with the world's poor over the next decade and a half, relying on the work of Sumner (2010) and Moss and Leo (2010). Section 3 considers the arguments and counterarguments for continuing aid to MICs. Section 4 makes a specific proposal for IDA. Section 5 concludes.

2. The Coming Disengagement of Aid and IDA from the Bulk of the World's Poor

Most if not all forms of concessional assistance have rules of access that limit or eliminate the availability of support to MICs. While the details vary and may be a little different from the exact official definition of the LIC/MIC threshold, graduation to MIC status essentially removes access to concessional assistance after a period of around three years. For example, the official World Bank threshold between LIC and MIC is $1,005 per capita Gross National Income (PCGNI) in 2010. The IDA threshold is a little higher, US $1,175 PCGNI in 2010. There are other aspects to IDA access such as access to capital markets, but here I will focus on the PCGNI criterion. The rules of access to IDA on this criterion are then specified as follows:

> "….the borrower will continue to access IDA resources on regular terms until the GNI per capita continuously exceeds the cutoff for three years." (World Bank, 2009, footnote 10)

Further, in a clause that is little appreciated by outsiders, repayment terms harden considerably once the threshold is crossed:

> "IDA credits include an acceleration clause, providing for the possibility of doubling of principal payments from creditworthy borrowers where per capita income remains above eligibility thresholds." (World Bank, 2009, footnote 6).

This "accelerated repayment clause" has been in IDA loan agreements for a while, but has begun to be exercised recently, and effectively halves the maturity of an outstanding loan upon graduation. It is perhaps this which "concentrates the mind" for IDA graduands—their outflows will double upon graduation. And in countries like India, which often has "back-to-back" on-lending from IDA to the central government and then to state government, it is the repayment of states that doubles.

What exactly will happen if the IDA rules of graduation continue to apply in the coming decade or so? Moss and Leo (2011) have conducted a careful projection analysis based on standard assumptions on growth (from the IMF's World Economic Outlook). Their findings are quite startling. We are currently in the middle of the 16^{th} 3-year cycle of IDA funding--IDA 16. By the time of IDA 21, around 15 years from now, IDA stalwarts such India, Sri Lanka, Vietnam, Zambia, Ghana, Kenya, Cambodia, Nicaragua, Bangladesh, etc. will have graduated. Around 30 countries will be left in IDA, with one third of the current population, 40% of the current allocation, largely African, and many that are currently fragile and poor performing.

Using a number of assumptions and projections on donor flows (essentially, continuation of recent trends), allocation rules and country performance (since IDA allocations are both need and performance based), Moss and Leo further calculate that the per capita allocation of countries that remain will double on average. With this broad framework, three possible scenarios are possible: First, with business as usual and unchanged rules of access, there will be a bonanza for the countries that do not graduate, with aid absorption issues being raised for many if not most. Second, donors could maintain current per capita allocation levels and take a "dividend" by reducing their aid flows. Or, third, rules of access to IDA could be changed to better deploy resources for the poor in graduated countries.

Sumner (2010) has calculated that in 2007-8 the top ten countries in terms of numbers of poor countries were India (456 million), China 2008 (208 million), Nigeria (89 million), Bangladesh (76 million), Indonesia (66 million), DRC (36 million), Pakistan (35 million), Tanzania (30 million), Ethiopia (29 million) and Philippines (20 million). Except for Tanzania and Ethiopia, none of these will be eligible for IDA resources after IDA 21. Of course, if growth and poverty reduction is faster in graduates than in non-graduates, the pattern may evolve. Chandy and Gertz (2011) have provided estimates for patterns of global poverty in 2015. They find that in 2015 MICs will account for 55% of the world's poor—and some of their assumptions (e.g. static inequality in MICs), may well overstate poverty reduction in MICs. It seems fairly clear that if current patterns and trends persist, then IDA will disengage from a large section, perhaps the bulk, of the world's poor.

While I have looked at specifics for IDA, it should be equally clear that the same fate awaits most other forms of concessional development assistance—many other multilaterals (such as the Asian Development Bank) follow IDA's structure for rules of access, and many bilateral are also set to disengage from MICs (e.g. DFID, 2010).

3. Why Continue Aid to the Poor in MICs? Arguments and Counterarguments

The central normative argument in favor of continuing development assistance to MICs stems for the imperative of the non-poor to help the poor, no matter where they are. Such "global Utilitarianism" would seek to aid the poor based on their poverty, not their nationality. Of course, informational and implementation constraints may mean that national PCGNI could be used as a proxy for poverty, or as an indicator for targeting resources most effectively towards the poor. This argument is developed in Kanbur and Sumner (2011). But, in this perspective, the national state per se would have no moral salience in and of itself in determining global moral responsibility towards the poor in that nation. They would command our attention because they were poor, period. The evidence on persisting poverty in MICs, based on global absolute standards, would thus call for continued aid to them from global resources targeted to poverty reduction.

Let us now consider counterarguments to this position. First is the counterargument that the poor in LICs are in fact poorer than the poor in MICs, so they should still command the lion's share of the aid resources. Now, the evidence is that along many non-income dimensions poverty is as severe in some MICs as in LICs. But the basic point is that this is an empirical question, not one of moral salience of LIC status per se. One should also highlight here that the issue is not one of income versus non-income dimensions of wellbeing. Take any dimension of wellbeing, or take any multidimensional index, and construct a threshold analogous to the "MIC/LIC" threshold on that dimension. If there are individuals who are poor in the newly defined "MICs", the fundamental question will not go away.

Another counterargument is that persistence of poverty in MICs is surely an indicator of lack of political will—lack of resources cannot be an issue by definition since the country is now a MIC. The response to this counter argument depends on how it is interpreted. If MIC status together with persistent poverty is taken as evidence of leakage of aid resources in their impact on poverty reduction, then of course this should have a consequence for aid allocation even with an objective of reducing poverty globally, no matter where it occurs. Such modification of targeting rules when efficiency of resources use differs is well appreciated. However, if MIC status together with persistence of poverty is taken to have moral salience above and beyond the targeting argument, that the poor in non-poor countries are less deserving of global resources because the primary claim should be on their own nation state, then this is a different category of counter argument.

A powerful counterargument, one that will play well in the political arena, is that many MICs have their own aid programs:

"Every so often something comes along which shows that almost everything you know about a subject is wrong. Such a development is happening in the world of foreign aid. It is a proposal by India to set up its own aid agency to distribute $11 billion over the next five to seven years. That's aid *from* India….This would be a departure. For decades, India was the world's biggest aid recipient. Now, it is likely to join Brazil, Russia and China in using aid to win friends and influence people abroad." (The Economist, August 13, 2011).

The Economist entitled this article, "India is thinking about setting up its own aid agency. Why should others give aid to India?" It is clear that from a political optic this is a killer counterargument. It would be difficult indeed to convince Northern taxpayers to give aid to India, when India itself gives aid.

However, consider the following rational argument, based again on the objective of reducing poverty no matter where it occurs. We know, of course, that there are leakages in aid. Some of the aid intended for the poor does not in fact reach the poor. Some of it finances the Presidential jet, or the acquisition of arms. The fungibility of resources makes this all the more potent, and it holds true in all countries, LICs or MICs. Attempts to minimize leakages abound in aid programs, from micro level monitoring to broad policy reforms. Now, one can think of worse forms of leakage than India giving aid to even poorer countries. At least, this is something to be discussed on a case by case basis, without taking a blanket position that being an aid donor is incompatible with being aid recipient. The Economist also ends up taking a more open position on aid to MICs:

"For Westerners, justifying aid will be harder. But there is a reason to give: like trade, aid benefits from specialisation and comparative advantage. Emerging countries, with recent experience to draw upon, might do a better job of infrastructure spending. The West should focus more on policies and good governance (something many poorer Indian states are crying out for). There is a new world of aid but over a billion people remain poor; they still need help, even if some of them live in countries that now give aid as well as get it." (The Economist, August 13, 2011).

While I have considered arguments in favor of continued aid to the poor in MICs on a type of global Utilitarianism which has as its objective poor people no matter which nation they live in, the counter arguments have the feel of ascribing a moral salience to the nation state in and of itself. There is lively debate on these issues in the conceptual and philosophical domain. Most interesting, perhaps, is John Rawls's departure from his "difference principle", put forward in A Theory of Justice (Rawls, 1971), when discussing international relations. In The Law of Peoples (Rawls, 1999), he does not advance a "global difference principle", which would focus attention on the poorest in the world no matter where they lived. Rather, the focus is on "well ordered peoples", whose obligation is to help other communities become "well ordered peoples." The tension between individuals and "peoples" is brought to the fore, and the salience of "peoples" in the international arena is highlighted.

From a quite different perspective, Miller (2010) departs from (what he considers to be) the extreme position of Peter Singer (1979) on the obligations of the well off no matter where they are to help the poor no matter where they are. Miller (2010) argues that a firmer foundation for aid is provided by focusing on international relations where one group of people is exploiting another. This is what establishes a moral basis for assistance, as redress for exploitative relations. In this view, therefore, whether a nation was MIC or LIC would be irrelevant; what would matter in establishing the moral case for aid would be the nature of the relations between that country and potential donors.

To conclude this section, then, much turns on the salience of the nation state per se in structuring the nature of global obligations to the poor. From one perspective, a poor country has claim on global resources, and a country that is not poor does not, irrespective of the nature of poverty at the individual level in these countries. From the other perspective, it is a poor person who exercises claim on global resources, irrespective of the nation in which he or she lives. Where one comes down along this divide will determine one's views on aid to middle income countries.

4. The Future of IDA—Windows of Opportunity

Faced with the scenario mass graduation of countries from IDA over the next decade and a half, Moss and Leo (2011) offer three possible scenarios:

" (1) *Stay the Course and Hope for the Best*: IDA could maintain its current allocation system and continue to argue every three years for replenishments at the current (or even higher) levels….(2) *Declare Success and Shrink Over Time*: Another option is to simply scale IDA down to meet the needs and size of the smaller client base. If IDA flows were held constant real per capita terms, then IDA-21 may in fact be the last replenishment for regular donor contributions….(3) *Launch A New Regional/Global Public Goods Window within IDA*: A third option is for IDA to complement – or even replace – its country-based lending model with a wholly different approach for funding global public goods (GPGs)…." (pp. 17-18).

The use of development aid resources to support addressing cross-border externalities and global public goods is of course a long standing issue in the development discourse (see for example, Kanbur, 2003; Kremer, 2006). However, the discussion in the present paper suggests strongly that IDA resources could also be targeted to the poor in MICs.

Specifically, consider the following proposal. **Between the current IDA threshold and twice this threshold, IDA resources would be available for projects and**

interventions targeted specifically to the poor—for example through projects focused on regions whose per capita income is below the IDA threshold, or through projects focused on sectors such as basic health and basic education which would reach the poorest of the poor.

If the above proposal is accepted then IDA would have two windows. The first window would be the standard window accessible only to countries below the basic IDA threshold. The usual IDA procedures would apply to this window. The second window would be accessible by countries above the IDA threshold but below twice the threshold. If one further accepts the thrust of the Moss and Leo (2011) "third option", there could be a third window for GPGs. These are the windows of opportunity for IDA's future, in the face of increased disengagement from the developing world and from poor people around the world.

There is much to be worked out on the implementation of this proposal, but (i) it still fits within the "per capita income threshold" framework, (ii) it merely intensifies the attempts at poverty targeting that already exist within IDA through regional and sectoral focus, (iii) it allows and invites greater focus on newer approaches to aid such as Cash on Delivery (COD—see Birdsall and Savedoff, 2010), and (iv) it puts a cap on continued access at around the midpoint of the range between the Lower Middle Income (LMIC) and Upper Middle Income (UMIC) thresholds.

Among the operational issues that would arise are:

(1) Exact delineation of poor regions or poverty oriented sectors. Regional per capita income could be used to target projects within a country. Only those regions that have not crossed the basic IDA threshold would be eligible. In India, for example, the poorest states would continue to have access to IDA until India's per capita GNI exceeded twice the IDA threshold. But for implementation this would require strengthening of sub-national income accounts.
(2) Performance based allocation for this window of IDA resources. Would the same allocation rules (based on the Country Policy and Institutional Assessment—CPIA) apply? Or might modified performance indicators, focused directly on poverty reduction outcomes, be more appropriate? (For an argument in favor of strongly outcomes-based approaches, see Kanbur, 2005. See also Leo, 2010).
(3) Some countries that have graduated but have not crossed the UMIC threshold will once again have access to IDA. Bringing these countries back into the IDA fold will require the appropriate reengagement, although of course there is IBRD engagement in any case.
(4) On the funding side, the issue of how much should be allocated to the new window, and on what criteria, will need to be discussed and worked out. Can donors earmark their contributions for a window? Or would the overall replenishment be allocated according to operational needs and performance criteria?
(5) More generally, governance structures for the new window, to which a limited number of MICs would have access, would need to be worked out.

These operational issues are challenging, of course, but they will need to be addressed if IDA is not to become disengaged with the bulk of the world's poor.

5. Conclusion

On a business as usual scenario, IDA will find itself focused on a small number of countries that do not contain the bulk of the world's poor. The same is true of most other forms of concessional development assistance. In order to prevent this disengagement, we need to start discussing the possibility of continued access to IDA resources for Lower Middle Income Countries, through a window that focuses on the poorest regions within countries, and on sectors that target the poorest. This window should be considered in parallel with other proposals, for example to create a window for Global Public Goods.

Such an evolution will not be easy for IDA. The structure of the rules of access has been pretty much unchanged for 50 years, and change is not easy. The new window will face opposition from the beneficiaries of business as usual—the countries that do not graduate over the next decade will get a sharp increase if donor flows continue. It may face opposition from donors, who may prefer to "declare victory" and reduce their contributions. This is an attractive option given the severe financial difficulties they face, and the argument that MICs have sufficient resources, and that some of them have their own aid programs, will play powerfully with domestic audiences. Further, the current policy is clear cut. As always, the alternatives are not so well defined and a number of options are possible. Each option will favor different beneficiaries in different ways, making it difficult for a coalition to form in favor of change. Finally, one should not underestimate the strength of feeling in some elite quarters of the new MICs that accessing concessional development resources does not comport with their self image and an emerging global role (for example, membership of G20).

However, as IDA is left with an ever smaller group of countries while poverty problems persist in MICs and need attention, global concern, and IDA's own self interest, requires a profound reflection on the rules and policies according to which it operates. This paper is a contribution to that process.

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