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Globalization and interdependence: science, technology and innovation for sustainable development

Development cooperation with middle-income countries

Report of the Secretary-General*

Summary

Middle-income countries play an important role in the global economy, accounting for approximately 75 per cent of the world's population and about 30 per cent of the global gross domestic product (GDP) at market exchange rates. However, notwithstanding their considerable progress over the past decades, they continue to face enormous challenges in all three dimensions of sustainable development. The coronavirus disease (COVID-19) pandemic has exacerbated many of those weaknesses and has had a devastating effect on middle-income countries.

Indicators based on GDP do not reflect those challenges, including fragmented social and economic structures, persistent inequality, inadequate health-care and education systems and economic bottlenecks such as commodity dependence, prevalence of low-productivity sectors, external debt burden and constrained fiscal policy space. A more comprehensive measurement method that goes beyond conventional GDP-based variables is needed. One specific suggestion is the use of a multidimensional vulnerability index that can identify structural weaknesses and inform policy priorities for structural transformations and the strengthening of resilience. Such an index could also facilitate smarter resource allocation and serve as the evidence base for the appropriate treatment of the debt burden of many middle-income countries.

Trade plays a crucial role in many middle-income countries. However, many of the countries depend on the export of a relatively small range of products, in many cases one or two commodities, and on the import of food and essential medicines and other health products. This structure poses a challenge for diversification and makes the countries particularly vulnerable to global disruptions such as the COVID-19 pandemic. Middle-income countries also face the possible rearrangement of global supply chains, creating new challenges for producers and buyers alike. At the

* The present report was submitted after the deadline so as to include the most recent information.



institutional level, middle-income countries have been particularly affected by strains on multilateral trading, underscoring the urgency of meaningful reforms.

Many middle-income countries are facing unsustainable levels of debt, compounded by the pandemic, which has eroded tax revenue precisely when more spending is needed to deal with the crisis. The excessive indebtedness has not only prevented many middle-income countries from responding robustly to the crisis, it has also constrained their ability to invest for future growth and resilience, thus weakening the prospects for a strong and sustained recovery. While immediate debt relief would provide significant help to many of the highly indebted middle-income countries, more fundamental changes are needed, including major improvement of debt management and reform of the current international debt architecture.

I. Overview

A. Introduction

1. In its resolution 74/231, the General Assembly requested the Secretary-General to submit a report to the Assembly on the implementation of development cooperation with middle-income countries at its seventy-sixth session. The present report is submitted in response to that request. It is based on the discussions and conclusions during the high-level meeting of the Assembly on the gaps and challenges of middle-income countries in the implementation of the 2030 Agenda for Sustainable Development, held in New York in June and July 2021.

2. The report is organized as follows: an assessment of recent economic trends and the macroeconomic situation in middle-income countries, in particular the impact of the coronavirus disease (COVID-19) pandemic, is presented in section I; the multidimensional vulnerability index and its potential role in the context of middle-income countries are discussed in section II; trade-related issues pertaining to middle-income countries, including structural issues faced by the multilateral trading system and the need for its reactivation to spur economic growth, are discussed in section III; the debt situation and debt sustainability in middle-income countries are discussed in section IV; and conclusions and issues for future consideration are presented in section V.

B. Role and importance of middle-income countries in the global economy

3. A total of 110 Member States belong to the group of middle-income countries.¹ They make up approximately 75 per cent of the world's population and about 30 per cent of the global gross domestic product (GDP) at market exchange rates (60 per cent if adjusted for purchasing power parity).² Given that middle-income countries represent the overwhelming majority of developing countries, achieving the global sustainable development agenda is impossible without addressing the developmental needs faced by this group of countries.

4. Middle-income countries are a very diverse group in terms of territorial size, population, geography, natural resource endowments and economic structure. Their economic and social conditions have dramatically improved over the past 50 years, significantly narrowing the gap between them and the developed world, but middle-income countries, in particular those in the lower-middle-income group, continue to face enormous challenges related to all three dimensions of sustainable development that are not reflected in their per capita income levels.

5. The above-mentioned challenges include fragmented social and economic structures, persistent inequality, inadequate health care and education systems, economic bottlenecks such as commodity dependence, the prevalence of low-productivity sectors, limited capacity for technology absorption and development,

¹ As at 1 July 2021, 110 countries are classified by the World Bank as middle-income countries for the fiscal year 2022. Among them, 55 countries belong to the lower-middle-income group, with a gross national income per capita of between \$1,046 and \$4,095, and 55 countries are classified as upper-middle-income economies, with a gross national income per capita of between \$4,096 and \$12,695. The calculations are based on the Atlas method, a classification used primarily by the World Bank as an operational guideline for determining eligibility for concessional lending.

² See <https://blogs.worldbank.org/opendata/size-world-economy-2019-baseline-which-measure-impact-COVID-19-and-track-economic-recovery>.

susceptibility to environmental shocks, external debt burdens and constrained fiscal policy space.

6. The challenges facing middle-income countries have been repeatedly discussed at several rounds of ministerial and high-level meetings convened under the auspices of the General Assembly,³ including the Fifth Ministerial Meeting of the Like-Minded Group of Countries Supporters of Middle-Income Countries, which was held in October 2020. The most recent round of those discussions was held in June 2021, at a high-level meeting on middle-income countries on the theme “Fine-tuning the development system approach to address the needs of middle-income countries”, at which the participants discussed strategies to overcome structural gaps faced by middle-income countries, the financial ecosystem of trade and debt and the challenges of financing the 2030 Agenda.

7. Robust and environmentally sustainable economic growth is a necessary, albeit insufficient, condition for bridging developmental gaps, and indeed during the past decade, GDP growth rates in most middle-income countries exceeded the global average. However, some upper-middle-income countries seem caught in a so-called middle-income trap, facing a protracted period of subdued growth rates impeding their convergence with high-income economies. Some that did achieve high-income status were unable to retain it, owing to either the deteriorating external environment or the fragility of their economic fundamentals. Moreover, some countries in the Caribbean saw their economies virtually destroyed overnight by natural disasters. Those experiences underscored the need to build up resilience to economic and nature-related shocks, overcome commodity dependence, diversify production and export bases, improve national institutions and enhance productivity.

C. Economic and sectoral trends and challenges in middle-income countries

8. The economic performance of middle-income countries in the period 2020–2021 was severely impaired by the outbreak of the COVID-19 pandemic in the first quarter of 2020. The pandemic, apart from creating an unprecedented global public health crisis, has had a devastating effect on these economies through the introduction of lockdowns and suspensions of economic activity, which have led to unprecedented job losses, disruptions in regional and global production chains and stagnating international trade, collapsing commodities prices and shrinking remittances in numerous other channels. Flows of foreign direct investment, including greenfield investment, have drastically shrunk. Manufacturing-dependent economies saw a relatively mild contraction in 2020, but tourism-dependent economies experienced the sharpest collapse. Across middle-income countries, weak demand, the decline in global foreign direct investment, the sharp contraction in the already limited fiscal space and the bleak economic outlook have suppressed investment, undermining future growth prospects and long-term productivity trends (China remained a notable exception because of much public investment funding). The pandemic also led to a massive capital outflow of over \$100 billion from the equity and bond markets of developing countries (most of them middle-income economies) in 2020, notwithstanding ultra-low interest rates in the advanced economies, significantly narrowing their policy space.

9. The fact that the aggregate GDP figure for upper-middle-income countries shows only a moderate contraction in 2020 (see figure I) is attributable to China,

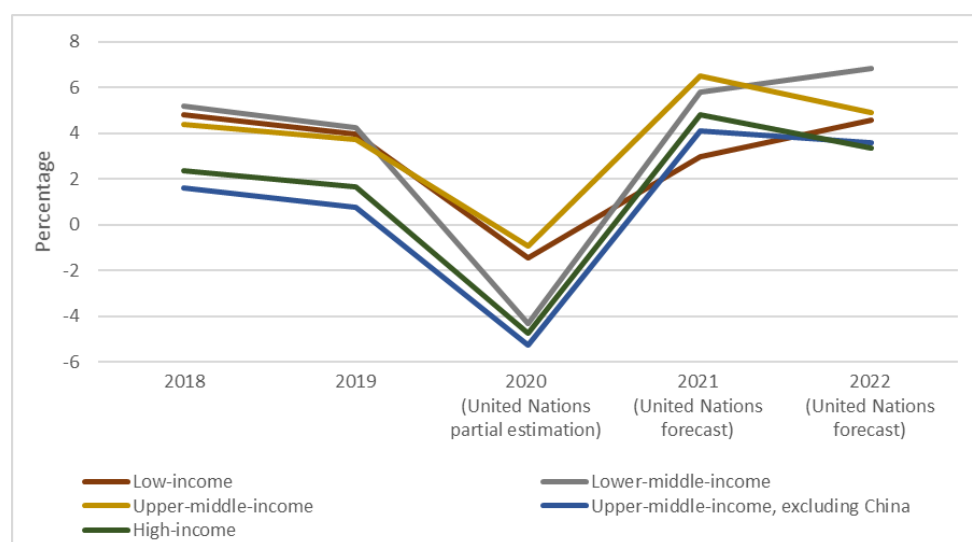
³ See, for example, <https://www.un.org/pga/73/event/development-cooperation-in-middle-income-countries/>.

whose economy expanded by an estimated 2.4 per cent in 2020 thanks to massive public investment programmes. Excluding China, the aggregate output of upper-middle-income countries shrank by over 5 per cent in 2020. Similarly, the projected strong economic growth in China in 2021 has increased the aggregate forecast figure.

10. Some middle-income countries, including Brazil, China, Egypt and the Russian Federation, managed to build robust growth momentum in late 2020 and early 2021 and were able to reach or exceed their pre-pandemic output levels as early as in the first half of 2021. However, in many middle-income countries, such as South Africa, and tourism-dependent Jamaica, Maldives and Montenegro, only a partial recovery is projected for 2021, with the return to pre-pandemic levels of economic activity not expected until 2022 or 2023. The aggregate growth rate of middle-income countries is forecast at 6.3 per cent in 2021 and 5.2 per cent in 2022.

Figure I

Annual real growth in gross domestic product by country group, 2018–2022



Source: Department of Economic and Social Affairs, “World Economic Situation and Prospects as of mid-2021” (update to *World Economic Situation and Prospects 2021*), data set.

11. Manufacturing-dependent middle-income countries, in particular those in East Asia that are integrated into global electrical and electronic production networks, namely China, have the best recovery prospects. For many others, in particular tourism-dependent economies, protracted stagnation is a real possibility. A combination of adverse factors, such as rising inflation (observed in 2021 owing to higher commodity and energy prices, supply disruptions and rebounding demand), the possible tightening of monetary and fiscal policies, a deteriorating epidemiological situation, persistent geopolitical risks and the threat of increased risk aversion, could derail economic recovery.

12. On the positive side, capital flows to middle-income countries are rebounding. For many of them, foreign direct investment inflows from China under the Belt and Road Initiative remain an important source of investment. The prices of some commodities have risen sharply in 2021, facilitating recovery for commodity exporters. Global remittance flows are also gradually recovering – remittances to Latin America rebounded strongly in the first quarter of 2021 thanks to economic stimulus in the United States of America.

13. The recession has caused enormous setbacks in progress towards the Sustainable Development Goals, generating a sharp increase in poverty and inequality and a deterioration in labour markets. The pandemic has disproportionately affected women and girls as a result of job and income losses, school closures and disruptions to education.⁴ A lack of reliable data is complicating the precise assessment of the social costs of the pandemic.

D. Macroeconomic policies

14. Most middle-income countries did not have sufficient policy space to implement countercyclical policies in response to the pandemic. With the notable exception of China, the fiscal responses of those countries have been significantly smaller than in the advanced economies. In developed countries, fiscal support amounted to about \$13,500 per capita compared with the global average of \$2,000, while announced government transfers and tax reductions in the United States reached 9.1 per cent of GDP in 2020 compared with just 2.4 per cent in India and 4.2 per cent in South Africa.⁵ Nevertheless, many middle-income countries strengthened their social protection systems. For example, several Governments in Latin America, including Argentina, Brazil and Peru, implemented measures to extend social protection to informal workers to mitigate the risk of increasing poverty and food insecurity.

15. On the monetary policy front, the central banks of some large middle-income countries, including Brazil, Indonesia and South Africa, enacted quantitative easing policies in 2020, purchasing government debt and other assets, which helped to reduce borrowing costs in local currency, although the volume, at about 2 per cent to 4 per cent of GDP in 2020, was modest relative to similar programmes in advanced economies.⁶

16. Many smaller middle-income countries, facing a public debt overhang and narrow fiscal space, had to resort to external borrowing, in particular through the Rapid Credit Facility and the Rapid Financing Instrument of the International Monetary Fund (IMF) and from regional development banks. Since March 2020, IMF has approved assistance to 58 middle-income countries (2021 country classification) for a total amount of \$78,537.39 million.⁷

17. In August 2021, IMF approved a record \$650 billion new special drawing rights allocation, with 58 middle-income countries expected to benefit from it.

E. International trade

18. Global trade in goods and services contracted by 8.1 per cent in 2020 owing to the collapse in demand and significant disruptions to global production networks. Trade in certain services, including tourism, came to a virtual standstill.

⁴ See Department of Economic and Social Affairs, "World Economic Situation and Prospects as of mid-2021" (update to *World Economic Situation and Prospects 2021*).

⁵ See United Nations Conference on Trade and Development (UNCTAD), box 1.1, "Trade and development report 2021: from recovery to resilience – the development dimension", September 2021.

⁶ The International Monetary Fund (IMF) has cautioned that open-ended asset purchase programmes may undermine credibility, create concerns about fiscal dominance and deter capital inflows. See IMF, "Emerging and frontier markets: a greater set of policy options to restore stability", in *Global Financial Stability Report: Bridge to Recovery* (Washington, D.C., October 2020).

⁷ Information is available at <https://www.imf.org/en/Topics/imf-and-COVID19/COVID-Lending-Tracker>.

19. A strong but uneven recovery in international trade is expected in 2021. While trade in services remains constrained by restrictions on international travel, merchandise trade has already surpassed pre-pandemic levels, reaching a record high in January 2021. Manufacturing exports from China and other East Asian economies have already been soaring since mid-2020. In some regions, however, merchandise exports remain notably lower than before the pandemic, mainly because crude oil and commodity exports have not fully recovered.⁸ By contrast, trade in services, in particular tourism, remains constrained by restrictions on international travel, and trade in commercial, maintenance and repair and construction services remains depressed. Information and communications technology and financial services represent a notable exception.

20. There are certain risks to the trade outlook, given that the above-mentioned developments in early 2021 are attributable in part to the restocking of inventories, and maritime freight rates and congestion in ports have surged. Post-pandemic consumption patterns are still difficult to predict, and uncertainties remain regarding the future of the Doha Development Round and reform of the multilateral trading system.

21. The pandemic has accelerated the digitalization of the digital economy and increased the significance of trade in services, which may challenge the traditional strategy of export-led growth through manufacturing sector development and participation in global value chains.⁹ The crisis has highlighted the importance of the digital divide, a significant challenge for middle-income countries in the future.

22. At the 2021 high-level meeting, it was stressed that middle-income countries must invest in technologies of tomorrow and not yesterday with regard to human capital, social protection, inclusion and infrastructure and, in particular, to address shortfalls in the digital infrastructure highlighted by the pandemic. Middle-income countries are lagging in adopting the technologies of the new industrial revolution, including artificial intelligence, thereby hampering their competitiveness and their efforts to move up global value chains.

23. Given the looming end of the low interest rate environment, it is ever more critical to connect financing with investment needs. High-level meeting participants noted that new investment inflows for long-term growth should ultimately be driven by the private sector, with the State creating a conducive environment by providing good institutions and investing in critical infrastructure, human capital and public health. International financial institutions can help countries to develop a sustainable macroeconomic framework. However, a large part of the public financing need, in particular with regard to climate adaptation, could be met if donor countries were to live up to their development finance commitments. In the report of the Task Force on the Digital Financing of the Sustainable Development Goals, ways to harness digitalization to finance the Goals were recommended.¹⁰

F. Trends in public debt

24. The crippling indebtedness of middle-income countries, many of which face an external solvency problem, severely curbs their prospects of recovering from the

⁸ According to the Organization of the Petroleum Exporting Countries *Monthly Oil Market Report* of September 2021, total world oil demand in the third quarter of 2021 was 98.4 thousand barrels per day, still below the pre-crisis level of 100.3 thousand barrels per day. See https://www.opec.org/opec_web/en/publications/338.htm.

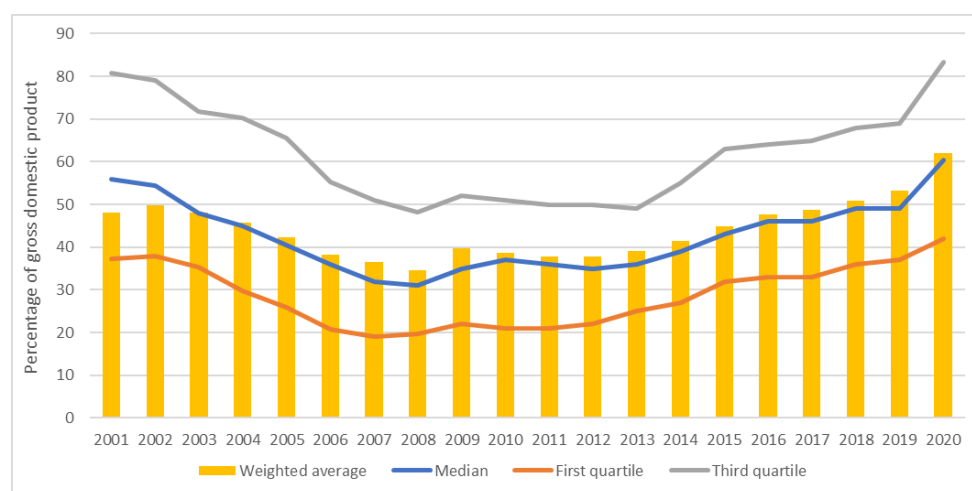
⁹ For a more in-depth discussion of trade-related issues pertaining to middle-income countries, see sect. III of the present report.

¹⁰ See <https://www.un.org/en/digital-financing-taskforce>.

COVID-19 crisis. The pandemic has exacerbated the debt situation considerably (see figure II). In the third quarter of 2020, the median debt-to-GDP ratio of middle-income countries rose to 60.5 per cent from 49 per cent in 2019. Their ratio of total external debt service to exports rose, from 14.7 per cent in 2019 to 17.5 per cent in 2020, the highest level since 2005, with an increasing share of private non-guaranteed debt, as well as the share of private creditors in the public or publicly guaranteed debt.¹¹

25. The loss of fiscal space caused by the sharp contraction of economic activity and, consequently, of tax revenues has been greatly exacerbated by the sharp increase in debt service payments due. The ability of many middle-income countries to gain access to additional fresh resources through new borrowing is constrained by their already high debt, and the increasing burden of debt service payments has impeded the efforts of most developing countries to respond adequately to the shocks of the crisis and to fund an ambitious and sustainable recovery.

Figure II
Total public debt in middle-income countries, 2001–2020



Source: Department of Economic and Social Affairs.

26. Some form of debt relief would be an important component of efforts to manage the situation. However, about 40 per cent of middle-income countries are not eligible for initiatives that alleviate the debt service burdens of developing countries, such as the Group of 20 Debt Service Suspension Initiative and the Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative. Many middle-income countries that are eligible for such initiatives have chosen not to request relief, fearing that downgrades by credit rating agencies and the loss of an investment-grade rating may curtail their access to commercial capital markets. Moreover, private creditors have not participated in such debt relief initiatives thus far.

27. The participants in the 2021 high-level meeting called for the United Nations system, in cooperation with multilateral development banks, to facilitate the design of new debt relief schemes and longer-term debt reduction initiatives,¹² as well as for

¹¹ See <https://unctad.org/news/debt-relief-and-productive-capacities-key-recovery-middle-income-countries>.

¹² For a more detailed discussion on debt in middle-income countries, see sect. IV of the present report.

the accelerated implementation of the Addis Ababa Action Agenda of the Third International Conference on Financing for Development.

G. COVID-19 pandemic in middle-income countries

28. As a result of the COVID-19 pandemic, there are tens of millions of new poor (those pushed below the threshold of \$1.90 per day). According to 2021 data from the World Bank, 82 per cent of the total new global extreme poor (or 72 million people) will be in middle-income countries, compared with 60 per cent of the existing global extreme poor. This is particularly true for African middle-income countries, most of which are commodity-dependent. If the higher poverty threshold of \$3.20 per day, which is typical of lower-middle-income countries, is considered instead, the share of middle-income countries in the population of the new poor owing to COVID-19 becomes even larger, reaching 90 per cent of the total, compared with less than three quarters before the pandemic. This is attributable in part to the loss of revenues from primary commodities owing to COVID-19 restrictions.¹³

29. For many middle-income countries, the reported number of confirmed COVID-19 cases may not reflect the actual epidemiological situation owing to inadequate access to testing. Available figures indicate that the overall number of reported cases per 1 million population in middle-income countries is lower than in high-income countries. As at mid-June 2021, the number of confirmed cases per 1 million population was about 1,900 in upper-middle-income countries and about 1,300 in lower-middle-income countries, versus about 6,300 in high-income countries.¹⁴ The corresponding number in low-income countries was even lower, at about 120. The lower figures may be attributable in part to the greater number of open-air activities, in particular in the agrarian countries, compared with the greater number of office and factory activities in most of the high-income countries; however, the reliability of those figures may be debatable. Significant gender disparities persist in some countries, with men displaying a disproportionately larger share of reported cases, exceeding 80 per cent, but those figures may simply reflect the inadequate access of women to COVID-19 testing.

30. Upper-middle-income countries had a higher mortality rate, at about 3 per cent per 1,000 cases, than high-income and lower-middle-income countries, where the respective figures were about 2 and 1.4, respectively, as at mid-June 2021. Consequently, the number of total COVID-19-related deaths per 1 million population stood at 56 in upper-middle-income countries and at 20 in lower-middle-income countries, well below that of 127 for high-income countries. The lower COVID-19-related mortality rate in lower-middle-income countries may be attributable in part to their relatively younger populations.

31. Middle-income countries lagged significantly behind the advanced economies in global vaccination efforts. In mid-June 2021, the ratio of total administered vaccine doses to population size was only 0.43 in upper-middle-income countries and 0.11 in lower-middle-income countries, compared with 0.7 in high-income countries. Some middle-income countries, even in the upper-middle-income group, exhibited exceptionally low ratios, at or below 0.01, resembling the situation in low-income countries with restricted access to vaccination.

¹³ See <https://blogs.worldbank.org/developmenttalk/shocks-and-vulnerability-poverty-middle-income-countries>.

¹⁴ Data from the Johns Hopkins Coronavirus Resource Center, available at <https://coronavirus.jhu.edu/>.

32. Participants in the 2021 high-level meeting called for urgent and internationally coordinated policy efforts to address the newly emerging challenges of middle-income countries and to assist in the countries' recovery. Such efforts would be especially important in ensuring universal access to vaccines (currently, many middle-income countries purchase them at commercial rates), which should be considered a global public good in line with General Assembly resolution 74/274. National vaccine production should be launched where possible and, if needed, exemptions from the World Trade Organization (WTO) provisions regarding intellectual property rights must be negotiated.

H. United Nations development system support for COVID-19 response and recovery plans

33. The United Nations development system is currently well positioned to address the developmental challenges of middle-income countries and to assist them effectively in responding to and recovering from the COVID-19 crisis thanks to recent reforms. At the onset of the pandemic, the United Nations system rapidly put in place a coordinated response in order to save lives, protect societies and facilitate the recovery. In particular, the Secretary-General launched the United Nations Comprehensive Response to COVID-19 framework and, in April 2021, established the COVID-19 response and recovery multi-partner trust fund, a United Nations inter-agency finance mechanism to support low- and middle-income programme countries in their response to the pandemic and its consequences. The fund complements the COVID-19 Strategic Preparedness and Response Plan 2021 of the World Health Organization and the consolidated global humanitarian appeal of the Office for the Coordination of Humanitarian Affairs regarding COVID-19.

34. Under the leadership of resident coordinators, 121 immediate socioeconomic response plans were rolled out, covering 139 countries and territories,¹⁵ many of them middle-income countries, supporting Governments with a rapid, coherent and well-coordinated response of the United Nations development system.

35. As was acknowledged during the 2021 high-level meeting, the response of the United Nations development system was extremely effective and well organized, in particular given its unprecedented scale, thanks to clear directions, top-to-bottom focus and comprehensive planning.

Small- and medium-sized enterprise surge project

The United Nations Development Account-led umbrella project of the global United Nations COVID-19 response has a small- and medium-sized enterprise surge project as one of its components. The surge project is aimed at examining how COVID-19 has affected micro-, small and medium-sized enterprises in developing countries and how competition policy can provide support in the economic recovery, stressing notably the access of such enterprises to markets. The prevalence of micro-, small and medium-sized enterprises as the economic backbone in developing countries makes the issue even more relevant to address.

¹⁵ See, for example, the report of the Secretary-General on implementation of General Assembly resolution 75/233 on the quadrennial comprehensive policy review of operational activities for development of the United Nations system: funding of the United Nations development system (A/76/75/Add.1-E/2021/57/Add.1).

In the economic recovery, small- and medium-sized enterprises and competition policy measures are an important issue, given that several potentially anti-competitive provisions have been tolerated in the crisis response, with potentially important impacts on such enterprises. Competition authorities will have to balance ensuring a level playing field with pushing forward for the economic recovery. The project includes an examination of ways to incorporate competition and/or policies regarding micro-, small and medium-sized enterprises in national recovery plans. An increase by competition authorities in advocacy programmes in relation to economic relief packages can ensure a level playing field for micro-, small and medium-sized enterprises. The project is aimed at heightening awareness of the interaction between micro-, small and medium-sized enterprises and competition policy in the digital markets, as well as increasing awareness of the role of competition policy in the promotion of such enterprises through trainings, seminars and workshops carried out by competition authorities.

II. Multidimensional vulnerability index in the middle-income context

A. Background of the multidimensional vulnerability index

36. The call for the development of indices that capture the vulnerabilities of States in order to better guide development financing has been issued in the United Nations system for well over three decades. The need for a globally accepted vulnerability assessment was first raised in 1992, at the United Nations Conference on Environment and Development (Agenda 21).¹⁶ The call was repeated by small island developing States in 1994, in the Barbados Programme of Action for the Sustainable Development of Small Island Developing States,¹⁷ and was endorsed by the General Assembly in its resolution 49/122. Between 1995 and 2003, the Assembly repeated subsequent calls for the development of the multidimensional vulnerability index.¹⁸

37. The unique challenges and particular vulnerabilities of small island developing States have been exacerbated by the socioeconomic impacts of the COVID-19 pandemic. In 2020, the Chair of the Alliance of Small Island States, Belize, wrote to the Secretary-General of the United Nations, reiterating the need to advance work on the multidimensional vulnerability index. Subsequently, in resolution 75/215, the Secretary-General was requested to provide recommendations to the General Assembly at its seventy-sixth session on the possible development, use, coordination and finalization of work on a multidimensional vulnerability index for small island developing States.

B. Potential role of the multidimensional vulnerability index in the context of middle-income countries

38. In his report to the General Assembly on follow-up to and implementation of the SIDS Accelerated Modalities of Action (SAMOA) Pathway and the Mauritius

¹⁶ See para. 17.100 (c) of Agenda 21, available at <https://sustainabledevelopment.un.org/content/documents/Agenda21.pdf>.

¹⁷ See A/CONF.167/9, paras. 113 and 114.

¹⁸ See General Assembly resolution 57/266.

Strategy for the Further Implementation of the Programme of Action for the Sustainable Development of Small Island Developing States (A/76/211), the Secretary-General made specific recommendations on the development of a multidimensional vulnerability index (including how work on it could be coordinated and finalized) and on its potential uses.¹⁹ He recommended that the process be led by Member States under the auspices of the Assembly, in a spirit of partnership and guided by an agreed set of principles.

39. In paragraph 84 of the same report, 10 possible uses of a multidimensional vulnerability index are set out, including to facilitate evidence-based and effective support and smarter resources allocation, allowing the use of a vulnerability component to complement performance-based allocation models, and to support and guide the design of innovative financing mechanisms and serve as a vehicle for providing exemptions or wider eligibility for access to development and concessional financing.²⁰

40. The above-mentioned potential uses of the multidimensional vulnerability index are of particular importance to middle-income countries, given that the gross national income-based threshold of eligibility criteria excludes most middle-income countries from access to concessional development finance and to the comprehensive debt relief available to low-income countries, not taking into account their particular vulnerabilities.

41. For developing middle-income countries, an internationally agreed multidimensional vulnerability index that is universal in its application can be employed to guide national and international policies, including on the promotion of resilient macroeconomic policies, by indicating structural weaknesses and identifying priorities for structural transformations. It can be used as a tool to facilitate evidence-based targeted and effective support and smarter resource allocation, as well as evidence-based decision-making for the development of smarter risk-informed national, bilateral and multilateral cooperation policies.

42. Resilient macroeconomic policies stemming from the use of the multidimensional vulnerability index would involve a number of dimensions and include the following critical objectives: (a) to discourage the accumulation of large external financial imbalances, unless used for productive investments that can finance debt repayments over time; (b) to promote financial market stability and the prudential behaviour of financial entities; (c) to foster the deepening and broadening of access to the financial system, including insurance; (d) to encourage responsible fiscal expenditure and adequate revenue collection, including through provisions for a social welfare safety net; and (e) to enable a flexible but fair labour market.

43. As noted above, the multidimensional vulnerability index could introduce a vulnerability component to complement the present performance-based allocation models and to support and guide the design of innovative financing. Importantly, it could facilitate extending eligibility for comprehensive debt treatment to all vulnerable countries, as well as inform approaches to debt.

¹⁹ Reference is made in the report to the development of a multidimensional vulnerability index for small island developing States. However, the second guiding principle for the development of such an index is that of universality, namely that the index be designed to capture the vulnerabilities of all developing States well so as to ensure credibility and comparability (see para. 81 (b) of the report).

²⁰ The Inter-Agency Task Force on Financing for Development has been tasked by the Economic and Social Council to provide an analysis early in 2022 of the potential use of the multidimensional vulnerability index for debt restructuring with the aim of building credit worthiness and expanding access to financing, including concessional financing.

44. The multidimensional vulnerability index could support and guide the formulation of country vulnerability-resilience profiles and underpin cooperation and partnership frameworks specifically designed to meet the needs of targeted vulnerable countries.

45. Lastly, notwithstanding the rationale, practicality and utility of the multidimensional vulnerability index, it cannot on its own generate the international consensus needed to increase the overall flow and quantum of available concessional resources. A unified advocacy effort, guided and led by a spirit of genuine partnership and propelled by the inescapable realities of the socioeconomic impacts of the COVID-19 pandemic on vulnerable States, is needed to achieve tangible progress in the use of the index.

46. The 2021 high-level meeting pointed to the need for a revamped perspective on development financing in middle-income countries. The eligibility for concessional funding determined by multilateral lending institutions should be extended to middle-income countries, many of which face catastrophic weather events that can entail the destruction of entire national economies. New and adapted financing tools are needed that take such vulnerabilities into consideration and build resilience against future shocks – natural disaster clauses in debt contracts are one example in this regard. Participants in the meeting saw a great opportunity for blended finance to crowd in private funding.

III. Trade-related challenges facing middle-income countries

A. Heterogeneity in the trade patterns, priorities and challenges of middle-income countries

47. The trade patterns of middle-income countries are very diverse. Many have their exports and even their GDP concentrated in relatively few products – for example, natural resources, such as oil and gas, or agricultural goods. Others have managed to enter into global industrial value chains of medium-sophisticated products, and some depend heavily on services sectors such as tourism. The low degree of diversification in the economies of many middle-income countries is a significant challenge. A second challenge facing the countries is their dependence on imports of food and essential medicines and other health products.

48. As tariffs have declined, the policies that inhibit international trade and investment flows are increasingly regulatory. Technical regulations such as the Agreement on the Application of Sanitary and Phytosanitary Measures and the Agreement on Technical Barriers to Trade that protect safety, health and the environment are needed and increasingly used, but they generate trade costs that are three times higher than tariffs. Such regulations have a disproportional effect on smaller businesses and women in middle-income countries. For many such countries, therefore, a third challenge is the difficulty of meeting the trade requirements in developed country markets.

B. Pre-pandemic problems in global trade

Structural issues in the multilateral trading system

49. As stated in the report of the Secretary-General on international trade and development (A/74/221), the multilateral trading system faced significant problems and challenges even before the outbreak of the pandemic. Multilateral trade cooperation under a rules-based system has come under increasing pressure from

unilateral actions, countermeasures, trade disputes and bilateral trade, even as trade within the multilateral trading system is expected to play a major role in achieving the Goals. Countries are placing increasing emphasis on national socioeconomic outcomes rather than on multilateral trade cooperation and development cooperation. The WTO dispute settlement mechanism, a key element for the rules-based multilateral trading system and its enforcement, has come under significant strain, in part as a result of the complexity of the legal cases put forward.

50. As heightened trade tensions threaten to paralyse the trade negotiation and dispute settlement functions of the multilateral trading system, major initiatives have been aimed at reforming and modernizing WTO. The reform proposals are essentially targeted at the following functions: (a) trade negotiation and rule-making, including the development dimension, namely special and differential treatment; (b) transparency and notifications; and (c) the dispute settlement mechanism, in particular Appellate Body functions. In some of the proposals, stress is placed on the importance of enhancing multilateral oversight of the unilateral measures that are driving many of the current trade tensions. The tensions have affected not only the outlook for trade but also the institutions and mechanisms that govern it.

C. Reinvigorating the multilateral trade system to spur economic recovery

Changing role of trade as an engine of development, and alternatives for middle-income countries

51. Middle-income countries have been dynamic players in bilateral, regional and interregional trade agreements. During the past two decades, they were the driving force behind innovative trade agreements in both South-South (e.g. African Continental Free Trade Area) and South-North (e.g. Regional Comprehensive Economic Partnership) frameworks. Moreover, some middle-income countries have been active in so-called joint statement initiatives on e-commerce, investment facilitation for development, services, national regulation and micro-, small- and medium-sized enterprises.²¹ The above-mentioned trends demonstrate the vital interest of middle-income countries in developing commonly agreed rules on trade for the twenty-first century. In addition, they confirm the need to reform the multilateral trading system so that it can become a stable and predictable trading framework suited to the trade concerns of today. Rebuilding an operational rules-based multilateral trading system and clarifying the legal aspects of joint statement initiatives within it would help middle-income countries to recover better from the pandemic though increased trading opportunities. Achieving specific outcomes at the twelfth Ministerial Conference of WTO, to be held in November and December 2021, such as on trade and health (including the Trade-Related Aspects of Intellectual Property Rights waiver) and fishery subsidies, is a sine qua non for the political survival of the multilateral trading system in the coming decade.

52. An urgent issue facing middle-income countries regarding market access is the ongoing trend of their graduation from special and differential treatment for developing countries, such as the non-reciprocal preferential market access provided under the Generalized System of Preferences schemes. The issue is closely related to the ongoing debate on special and differential treatment at WTO, in which the Group of 90, a coalition of African, Organization of African, Caribbean and Pacific States and least developed country members of WTO, is calling for WTO to review,

²¹ The joint statement initiatives were launched at the eleventh Ministerial Conference of the World Trade Organization, held in Buenos Aires in 2017.

strengthen and make more precise, effective and operational the provisions on special and differential treatment to enable developing countries and least developed countries to be further integrated into the multilateral trading system, while the United States and selected developed economies view special and differential treatment on the basis of self-declaration of development status as not truly equitable for the countries in need.

D. Impacts of the COVID-19 pandemic on trade

Services trade

53. The pandemic has highlighted the power of digital technology in transforming the interaction of demand and supply in international trade, in particular in the services sector. In 2019, before the pandemic, services already accounted for 25 per cent of total trade in middle-income countries, and those countries were responsible for 8 per cent of global services trade in that year.²² Middle-income countries have significant opportunities in the digital transformation of services to build dynamic comparative advantages. Furthermore, more robust services sectors contribute to economic diversification. The development of services thus forms an essential component of the competitiveness strategies of middle-income countries and is essential to avoid or escape the middle-income trap.

54. Several forms of services trade can address both stability and efficiency concerns in post-pandemic trade flows. For example, information and communications technology-enabled services can help middle-income countries to become significant providers within global value chains of services embedded in the production of goods (e.g. design) or those embedded in the production and sale of goods (e.g. transport, marketing, retail and after-sale services). Information and communications technology services or financial services, on the other hand, are necessary enablers of a wide range of economic activities, each of which generates value for the entire economy. Other services, such as hospitality services, involve relatively limited interaction with other economic activities, although they do provide jobs to many low-skilled urban populations. Policymaking for services development with an eye to economic diversification thus requires a multifaceted approach.²³

Impacts on women and on gender equality gains

55. The pandemic has had a strong and negative impact across income groups, sectors, countries and gender, exacerbating existing inequalities. Women have been affected by employment loss to a greater extent than men: women's economic activities are often clustered in the sectors that are the most affected by lockdown measures, in particular the services sector, women hold more casual and seasonal employment than men and women hold jobs that are less likely to be carried out remotely.

56. The pandemic has also had a negative impact on the participation of women in the labour market. More women than men left the labour market entirely in 2020, discouraged by having lost their jobs and overburdened with household

²² Services inputs accounted for 33 per cent of the value added of total exports of goods and services in developing countries. See https://p166.unctad.org/pluginfile.php/38652/mod_page/content/10/Services%20value-added%20-%20TSD%20overall%20Final.pdf and <https://unctad.org/project/measurement-services-value-added-exports-and-analysis-related-services-and-trade-policies>.

²³ See <https://unctad.org/news/coronavirus-deals-severe-blow-services-sectors>, <https://unctad.org/news/services-sector-vital-COVID-19-economic-recovery>, <https://unctad.org/news/securing-access-financial-services-vulnerable-people-during-COVID-19> and <https://unctad.org/news/COVID-19-shows-need-close-financial-inclusion-gender-gap>.

responsibilities owing to the closure of schools and day-care centres. The significant decrease in the number of women actively searching for a job threatens to reverse decades of progress towards the empowerment of women.²⁴

57. More women than men are represented in the informal sector, and informal workers overall have been particularly affected by the effects of the COVID-19 pandemic and largely excluded from most benefits and programmes put in place during the emergency response to the pandemic.

58. Informal cross-border trade makes up 40 per cent of regional trade and is a major characteristic of the economic and social landscape in Africa. Women make up the largest share of informal cross-border traders, representing between 70 per cent and 80 per cent of them in some middle-income countries in Africa.²⁵ Mobility restrictions have taken a particularly heavy toll on those who earn a living in this way, while new requirements, such as the holding of health certificates to cross borders, have imposed additional costs and risks.

59. For central authorities, the task is not only to facilitate cross-border trade through, for example, simplified trade regimes but also to help to familiarize traders with existing rules and procedures. Authorities should also simplify requirements and create attractive conditions, for example by relaxing registration formalities or making registration possible at the border, so that small entrepreneurs want to formalize their business.²⁶

Commodities

60. The outbreak of COVID-19 was a unique shock to both the demand for and the supply of commodities. Oil markets have been the most affected, given the collapse in travel arising from mitigation measures. The demand for oil experienced an unprecedented decline, and oil prices have suffered their steepest one-month decline on record. Metal prices have also fallen, although less than those of oil, while agricultural prices have been much less affected.²⁷

61. The impact of the COVID-19 pandemic on energy markets could be felt for many years. Declining demand and a lack of storage capacity sent crude oil futures temporarily into negative territory. Brent oil averaged about \$43 per barrel in 2020, about one third below the 2019 average of \$64 per barrel. However, for 2021, a rebound to \$60 to \$65 per barrel is expected as economic activities pick up and travel demand returns.²⁸

62. Overall, dependency patterns seem to have at best been maintained because of the pandemic shock. At worst, and in particular among highly dependent commodity exporters, the pandemic has further accentuated a fragile macroeconomic situation that was already under pressure owing to heightened price fluctuations in several commodity markets.²⁹

²⁴ See <https://unctad.org/news/gender-and-unemployment-lessons-COVID-19-pandemic>.

²⁵ UNCTAD, *Borderline: Women in Informal Cross-border Trade in Malawi, the United Republic of Tanzania and Zambia* (Geneva, 2019).

²⁶ See <https://digital.intracen.org/issue1-21/focus-cross-border-trade/>.

²⁷ See <https://thedocs.worldbank.org/en/doc/558261587395154178-0050022020/original/CMOApril2020SpecialFocus1.pdf>.

²⁸ See https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/WESP2021_CH2.pdf.

²⁹ See https://unctad.org/system/files/official-document/ser-rp-2020d11_en.pdf.

Creative industries

63. The cultural and creative industries represent a growing segment of the modern economy, generating about 30 million jobs worldwide. Some 45 per cent of people employed in the creative industries are women, and 20 per cent are 15 to 29 years of age, far younger than in any other sector. Between 2003 and 2015, before the COVID-2019 pandemic, exports of creative goods and services grew at an average annual rate of 7.3 per cent.³⁰ The pandemic-induced lockdown and confinement measures brought several subsectors to a near halt – the music and performing arts subsectors recorded staggering losses of 75 per cent and 90 per cent, respectively.

64. Many middle-income countries have strengthened their digitalization strategies, thus enabling the development of digital services and a global value chain model, as well as providing the opportunity to offer digital creative services to a worldwide audience. Cross-border trade in creative industries can be a significant contributor to post-COVID-19 growth in middle-income countries, which can benefit from technological advancements, and it can improve productivity in the creative economy. However, monetizing artistic and cultural content on digital platforms everywhere is critical, as is securing fair remuneration for artists and creators in the new digital cultural economy.

E. Global value chains and their shortening/renationalization

Pre-pandemic structure of value chains

65. Middle-income countries play a central role in global value chains, some through their exports of important resources and others through industrial production. The ongoing debate on global value chain-associated risks and how to reduce the fragilities of the chains, which was brought to the forefront by the pandemic, is therefore of central importance to the countries.

66. Speculation about a possible gradual renationalization of value chains in a post-pandemic world is gathering steam. However, it is hard to overlook the fact that many countries have turned to global value chains to address shortages and increase supply. Trade was a major channel for global economic disruptions at the outset of the pandemic, but it has subsequently contributed significantly to mitigating demand and supply shocks and will be an essential part of recovery from the crisis. Global supply chains are a pillar of global economic activity and a source of livelihoods for millions of people in many low- and middle-income countries, and the recovery will be uneven and incomplete if those people are excluded from the chains.

67. The post-pandemic resilience and robustness of global value chains should be the key focus, with the diversification of supplier bases and consideration of new investment destinations helping to build resilience to future shocks and disruptions. Trade-related regulations, specifically non-tariff measures, play an important role and could be deployed judiciously to achieve more decentralized production of essential goods. However, renationalization may not generate the desired outcome in all cases – there is no irrefutable evidence that shorter supply chains are less vulnerable.

68. Another critical dimension will be sustainability. Industrialization and the lengthening of food supply chains multiply the number of intermediaries and can contribute to an increase in environmental risks. Sustainability standards should serve as instruments through which countries can make global value chains more

³⁰ See <https://unctad.org/news/creative-economy-have-its-year-sun-2021>.

sustainable. Strengthening regional value chains among developing countries will help to avert the potential risks of reshoring.³¹

69. Participants in the 2021 high-level meeting agreed that the multilateral trading system provides various entry points into value chains by improving transparency regarding trade restrictions, facilitating investment discussions, protecting intellectual property and levelling the playing field. Policies to facilitate cross-border trade can enable middle-income countries to create end-to-end production chains, thereby contributing to diversifying their economies.

IV. Managing the debt situation in middle-income countries

70. The COVID-19 pandemic has put the vulnerabilities caused by the high level of public debt in middle-income countries in stark relief. Debt levels and debt service obligations that had seemed manageable in many of those countries two years earlier became suddenly and obviously unsustainable as the economic shutdowns shrank tax bases and revenues. Most middle-income countries lacked the fiscal space to fund a vigorous emergency response and a robust recovery, and they have no room for additional borrowing.

71. Immediate debt relief would be a significant help to many highly indebted middle-income countries, but most are ineligible for major debt relief initiatives owing to their higher levels of per capita income. Even if middle-income countries were eligible, the non-participation of private sector creditors in such initiatives limits the scope of the relief that they could provide to the countries, which are much more exposed to private creditors than low-income countries.

72. Debt relief alone would not resolve the inherent vulnerability of highly indebted developing countries in the absence of decisive measures to restructure, reprofile or reduce the stock of the debt. The international community has reflected on the issues in the context of the Initiative on Financing for Development in the Era of COVID-19 and Beyond and other forums. Most of the key conclusions and recommendations resulting from the processes are of particular relevance to middle-income countries.³²

73. A major recommendation is that the Group of 20 extend the Debt Service Suspension Initiative until at least June 2022 and include among the eligible countries indebted middle-income ones that have been deeply affected by the crisis, including small island developing States and conflict-affected countries. A second recommendation is that the Initiative be complemented by mechanisms to include private sector creditors in the current initiative and possible future debt relief efforts. It is also proposed that the Group of 20 extend the Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative to other countries in need on a case-by-case basis and complement it through advice on and support for other options for debt and debt service relief, such as swaps, buy-backs, credit enhancements, reprofiling or exchanging debt and/or cancellation.

74. Beyond the possibility of providing debt relief to free up fiscal space and enable countries to step up their recovery efforts, two other considerations warrant close attention. First, while persistently low global interest rates may have created a false sense of security, the fact remains that many countries continued to run up their debt despite clear warnings from various quarters in the international financial community. Debt management needs major improvement at all levels, reinforced through greater

³¹ See https://unctad.org/system/files/official-document/sgs2020d1_en.pdf.

³² Conclusions and recommendations presented in the policy brief “Liquidity and debt solutions to invest in the SDGs: the time to act is now”, available at <https://unsdg.un.org/sites/default/files/2021-03/sg-policy-brief-on-liquidity-and-debt-solutions.pdf>.

transparency in data and reporting on debt flows, to avoid a recurrence of the problem facing developing countries today. A much more sophisticated analysis of debt sustainability is also needed, supported by adherence by borrowers and lenders to responsible borrowing and lending practices based on internationally agreed principles.

75. Second, the current international debt architecture is in need of reform, having repeatedly proved itself incapable of preventing the emergence of debt crisis situations or facilitating their resolution. Several proposals have been put forward that build on the Addis Ababa Action Agenda and other international agreements, as well as on existing mechanisms. Some, such as for the creation of a global forum for sovereign debt resolution and coordination, are quite far-reaching and may require considerable discussion before agreement is reached. Whatever changes are ultimately agreed, it is essential that any reform of the international debt architecture be based on the full and equitable participation of developing countries in the decision-making processes, enabling them to bring their voices fully to bear.

76. Two potential aspects of the reform should be carefully considered by middle-income countries. First, as noted above, one potential use of the multidimensional vulnerability index would be to serve as a tool to inform approaches to debt restructuring, act as a vehicle for comprehensive debt treatment and allow exceptional eligibility for vulnerable States. The index, once in place, could thus reinforce the call for appropriate debt relief to debt-vulnerable middle-income countries, inform the redefinition of debt sustainability and contribute to enhanced debt management practices. However, agreement to use the index to determine the eligibility of such countries to obtain access to concessional financing would not in itself lead to any significant increase in the overall volume of such resources. Moreover, a multidimensional vulnerability index that included an assessment of endogenous, policy-based factors of vulnerability would highlight any deficiencies and could therefore contribute to a ratings downgrade.

77. Linked to the above-mentioned aspect is rising dissatisfaction with the methodologies and practices of private credit rating agencies. It has been proposed that the risk of credit rating downgrades be addressed through engagement with investors, market participants and the ratings agencies themselves, as well as by establishing long-term credit ratings to complement existing short-term ones. There has also been increasing discussion of the possible creation of an international public credit rating agency serving a function similar to that of private ratings agencies but focused on sovereign ratings and acting as a counterweight to the influence of the private agencies.

78. The participants in the 2021 high-level meeting underscored that the international community should urgently address gaps in the international debt architecture. They concurred that existing debt relief initiatives should be expanded to cover all middle-income countries to provide them with much-needed fiscal space, and they urged the Group of Seven and the Group of 20 to develop a longer-term framework for debt relief that is able to deal effectively with heterogeneous creditors. The Group of 20, IMF and the World Bank need to coordinate with one another to provide credit for investment outside debt relief. Multilateral development banks are encouraged to design new schemes for debt relief and longer-term debt reduction initiatives. The participants in the meeting recommended that the private sector be better informed of the conditions of debt instruments to avoid unnecessary ratings downgrades.

V. Conclusions and issues for future consideration

79. The impact of COVID-19 has been universal but uneven. A lack of both fiscal space and significant international support has prevented many countries from reacting with a vigorous emergency response and will continue to prevent them from funding a robust recovery. More important, the failure of the international community to ensure the universal and equitable access of all countries to vaccines means that the economic recovery itself will be uneven as well as prone to renewed restrictions and shutdowns and a surge in infections among unvaccinated populations.

80. Middle-income countries are at risk of losing many of their hard-won gains in development and of falling farther from the path to sustainable development. Absent a major turnaround in their revenue mobilization efforts, and without major debt relief and restructuring efforts, they will be unable to rebuild their economic and social resilience or to deliver essential public goods and the critical public investments needed to create a conducive environment to attract the necessary private capital.

81. Many middle-income countries face the serious challenges of inequalities, the lack of adequate decent jobs, in particular for young people, and the need for investments in their education, public health and social protection systems and in sustainable urban infrastructure. They must also overcome the digital divide laid bare by COVID-19, adopt and adapt to new technologies to enhance their productivity and global competitiveness and address the climate, biodiversity and pollution crises, individually and collectively. All the above-mentioned actions are necessary to avoid or escape the much-maligned middle-income trap and continue their progress towards sustainable development.

82. Analysis of the trade and debt situation of middle-income countries indicates that the solutions to the issues lie in multilateral cooperation. Middle-income countries are a very diverse group, but there is much advantage to coming together in closer cooperation as the issues are discussed and negotiated in global forums. The potential of South-South cooperation and triangular cooperation should be fully utilized to facilitate technology transfer, develop infrastructure and accelerate industrialization, as well as to exchange best practices and build consensus regarding some of the changes and reforms needed to respond to the trade and debt problems of the countries.

83. Despite the above-mentioned issues, much can be done at the national level to enable and secure progress. Rational, integrated and predictable policymaking that is consistent with the sustainable development agenda and international commitments like the Paris Agreement will mitigate some of the vulnerabilities and perceived risks that hinder efforts to mobilize national resources and attract foreign capital for investment. Governments must ensure that their policies and regulations do not support or encourage unsustainable activities and must encourage all stakeholders to work towards building a sustainable, inclusive, low-carbon and green economy. By aligning their budgets carefully with the Goals, Governments can use the available fiscal space more effectively to achieve sustainable development.