

Eurodad briefing on the European Commission's April 2009 development finance communication: "Supporting Developing Countries in Coping with the Crisis".

On 8 April the EC released its annual communication package assessing European governments' progress in implementing their financing for development pledges. This year the financial crisis is prominent, as is follow-up to international conferences in the second half of 2008, namely the Third High-level Forum on Aid Effectiveness in Accra (HLF3) and the Follow-up International Conference on Financing for Development in Doha. The package contains some interesting analysis of the impacts of the crisis, the status of EC financing for development implementation, plus 28 pledges, though not all of them new. This Eurodad briefing summarizes and assesses the main elements on four issues central to our work: aid effectiveness, debt, reform of international financial institutions, and taxation.

The Communication consists of an overview paper titled "Supporting developing countries in coping with the crisis" and four EC staff working papers on Financing for Development (FfD), Aid for Trade, Aid Effectiveness and the MDGs.¹ The analysis and recommendations are primarily based on a questionnaire that the European Commission DG Development sends each year to EU Member States.² This is a useful, if limited, accountability exercise. It shows that much more needs to be done to implement existing European commitments on development finance, and to go further now that the financial and economic crisis is severely affecting developing countries and may push a further 100 million people into poverty in 2009.

1. Aid Effectiveness

The Commission concludes overall that Member States are not fulfilling either their quantity or quality commitments. On quantity the Commission finds that the "overall trend is in the right direction. But the pace for moving to the individual baseline targets is by and large insufficient" (FfD Paper, p. 26). Worryingly, however, it hints that the OECD Development Assistance Committee should "continue to reflect" on whether the ODA definition should be extended to peace and security related activities in development countries (FfD Paper, p. 32). It also refers to a so-called "Whole of the Union" approach where export credits, investment guarantees and technology transfers are counted towards the EU's development contribution. The paper calls for "every euro spent on aid [to] leverage five euros in non-ODA" (Overview paper, p. 5). While positive and negative contributions to development certainly go far beyond ODA, civil society organisations will challenge further dilutions of the official aid definition or distraction from implementing the aid targets.

For the EC, "the international agenda for improving aid effectiveness is in place. What is needed now is determined implementation" (Aid Effectiveness Paper, p.3). CSOs criticized the Accra Agenda for Action for limited progress in crucial fields such as technical assistance, conditionalities and aid untying, but welcomed the 48 new or strengthened commitments that it added to the 12 previous indicators of the Paris Declaration.³ The EC produces a useful table summarising progress towards the 2010 aid effectiveness targets (p. 4).

¹ The Communication, staff working documents and a citizens' summary – some 190 pages in all – are available at: http://ec.europa.eu/development/services/dev-policy-proposals_en.cfm. The Communication is also in French and German.

² Questionnaire available at: <http://ec.europa.eu/development/icenter/repository/EU-progress-on-financing-for-development-and-MDGsQuestionnaire11-12-2008.pdf>.

³ See Eurodad's analysis of the Accra Agenda for Action at: <http://www.eurodad.org/aid/article.aspx?id=124&item=2822>

The EC also estimates the financial costs if EU donors fail to implement the full aid effectiveness agenda. These range from €25 to €35 billion between now and 2015, or €5-7 billion a year (Overview Paper, p. 7). This is official endorsement that inefficiencies in the current European aid system amount to some 10% of total aid spending. Further details of the EC's calculations on this are promised in a study due out this summer. Eurodad is in touch with the officials undertaking this and will analyse the findings so they can be used to reduce aid transactions costs and ensure more money reaches those who need it on the ground.

On implementation of aid reforms, the EC finds that "progress has been made, but too little and too slow" (Aid Effectiveness Paper, p.3). It has picked four areas of the complex aid effectiveness agenda to demonstrate this: division of labour, use of country systems, mutual accountability for results (including less conditionality) and predictability of aid flows. If targets are to be achieved in the short time left until the 2010 deadline, "efforts need to be stepped up dramatically" (p. 3).⁴

Division of labour: In 2007 the EU adopted the Code of Conduct on Complementarity and Division of labour,⁵ which obliges Member States to reduce aid fragmentation by reducing the number of countries and sectors they are engaged in and/or by delegating cooperation to another donor. The EC's new communication records that while 20 Member States have expressed interest in improving the division of labour, five are not yet ready to act due to capacity constraints or prohibitive policies and legislation. Several donors have reduced the number of priority countries, but the EC recognizes "that there clearly is plenty of room for donors to further concentrate their aid" (p.10). Leader in aid fragmentation is the Commission itself, which is, the paper states present in 144 developing countries "because of its mandate".

Member States told the Commission in their questionnaire responses, that impediments to change include their wish to remain engaged in politically attractive sectors, the lack of visibility when cooperation is delegated, the perception that coordination is time-consuming and not cost-effective for some interventions, the lack of overview on what different donors are doing in a given country or region, and in some cases hesitations by recipient countries that fear losing aid for particular sectors.

Use of country-systems: Many Member States claimed they had problems finding accurate data – only eleven informed the Commission about their use of recipient governments' Public Finance Management procedures, for example. This is worrying as the EC is supposed to help guide Member States' aid effectiveness reforms. The new Commission paper refers to the findings of the OECD's 2008 Survey on Implementing the Paris Declaration that although progress has been made in improving recipient countries' public financial management systems, "there was no corresponding increase in donors' use of those systems" (p.12).⁶

One major impediment is the mode in which aid is delivered. Project aid and technical assistance remain the most widely used mode by EU donors, although "a quarter or more of their ODA support through programme-based approaches. For three this consists mainly of budget-support" (p.12). While the EC promises €500 million this year to support African, Caribbean and Pacific countries hit by the crisis, only five EU countries now say budget support is their preferred way to scale up aid to Africa, down from 10 in the 2008 Communication (FfD paper, p. 34). Audit and similar institutions in donor countries still lack trust in the use of recipient country-systems. In some Member States the current legislation hinders better use of country-systems, two have started a review process.

Conditionality: The EU acknowledged in its Guidelines for Accra that "conditionality must be reformed in order to give partner countries the necessary sovereignty on their development strategies" (p. 14). Here as well "much remains to be done" (p.14). Only five Member States told the Commission that they are actively reducing the number of conditionalities, while 13 are not, and no result is recorded for the remaining nine Member States. Interestingly, most

⁴ If no document name is given the reference is to the document previously cited .

⁵ Available at: <http://europa.eu/scadplus/leg/en/lvb/r13003.htm>.

⁶ See also Eurodad's analysis of the OECD's 2008 Paris Monitoring Survey. Available at: <http://www.eurodad.org/whatsnew/articles.aspx?id=2802>

Member States responded that conditionality is not a relevant problem for them, and only two admitted to apply conditions which are not mutually agreed with partner countries. (The reason might be that many conditionalities are imposed by intermediaries such as the World Bank and the IMF, or aid dependent countries might accept them in anticipatory obedience.) Some 14 EU Member States still do not make their conditions public, although this was one of the commitments in the Accra Agenda for Action that was supposed to take instant effect. To improve this the Commission proposes a global accord to insert a standard clause into budget support and similar donor recipient agreements.

Predictability: The EU Guidelines for Accra also acknowledged the need for greater predictability. Some progress has been made, however in many Member States “domestic legislation or the need to strictly respect annual budget cycles still present constraints” (p.16). The Commission itself has established the “MDG contracts” which allow for a six year timeframe for aid disbursements, but so far there seems to be little support from Member States to co-finance these contracts.

2. Debt

The financial crisis threatens a new debt crisis in many developing countries, but this issue is quite obviously not high on the EC’s agenda this year. The Communication dedicates just three pages in the Financing for Development paper to external debt. It acknowledges that many post-HIPC countries were led into new borrowing since 2007, because they have been exposed to a succession of shocks - shocks which were caused in particular by high and volatile food and energy prices.

Even though the overview paper recognizes that due to the financial and economic crisis “developing countries will face a financing gap of \$270 to \$700 billion this year” (p. 3), the Commission’s FfD paper does not recommend sufficient counter-measures. Debt sustainability in developing countries is a major concern for the EU, but Member States preference is to enhance existing debt management mechanisms. Only a minority of Member States acknowledges the need for a sovereign debt restructuring mechanism - they are herewith showing little commitment to implement the Doha Declaration on Financing for Development in this regard. The Commission, however, insists that it and the Member States “should promote a discussion on enhanced sovereign debt restructuring mechanisms” (overview paper, p. 12). It should also be mentioned that the Communication totally omits to address other crucial fields of the debt agenda such as debt audits and illegitimate debt.

3. International Financial Institutions

The Financing for Development Paper welcomes “the current international debate to review the international financial and monetary architecture and global economic governance” (p. 41). It also welcomes existing initiatives of World Bank and the IMF reform, as well as the limited measures agreed by the G20 leaders in London on 2nd April.⁷ These include:

- the IMF “reform of quota and voice, as agreed in April 2008”;
- the unambitious agreements for World Bank reform reached at the Annual Meetings last year, “including an additional seat for sub-Saharan Africa on the Bank’s board and the increase in developing and transition countries’ voting shares in the IBRD and IDA”; and;
- setting up “an open, transparent merit-based process for selection of the IMF Managing Director and the WB president”.

It is regrettable that the Communication simply restates existing and very timid measures which European Member States and the Commission have publicly stated in recent years, but not implemented because of a lack of political will. It is also regrettable that the suggestion to realign “shareholdings in the Bank, considering the evolving weight of all members in the world economy” is the only suggestion to go beyond the insufficient global agreements. The World Bank claims to be a development institution and, as they are most affected by its decisions, poorer countries need to have a much greater say in the institution’s governance.

⁷ See Eurodad’s analysis of the G20 communiqué: www.eurodad.org/whatsnew/articles.aspx?id=3539

Although the Communication mentions the need to improve the IFIs' lending instruments, the document is silent on the need to reform IFI conditionality policies. While the European Commission has adopted a more progressive conditionality policy in its development aid, the Communication fails to call for further progress on reforming conditionality policy at the IFIs. It is unfortunate that the Communication, while calling to "safeguard and consolidate the IFIs' role" (p. 42), omits to analyse how these institutions pressed developing countries to implement the finance and trade liberalization policies which the EC recognizes have exacerbated their vulnerability to global financial crises.

Europe's own IFI, the European Investment Bank (EIB), is gaining prominence. Eight of the 28 recommendations listed in the overview paper are addressed to the EIB. This institution, which in recent years has been lending more external to the European Union, is supposed to become a major tool to "frontload" financial transfers to developing countries in times of crisis. It shall, for example, increase its lending on infrastructure and energy projects, support multilateral initiatives on trade finance and work together with the Commission to provide investment guarantees. Since the EIB lacks development policies or lending criteria and can thus not ensure that its loans are spent on poverty alleviation purposes, there is a considerable risk that the EU will disburse a lot of "bad aid" in the near future.⁸

The Commission also mentions the "central role (of the UN) in the multilateral system (as) the only body where consensus can be built between all States and regions, including those currently under-represented in or missing from economic and financial governance structures" (FfD paper, p. 42).

4. Taxation and capital flight

Taxes are covered very extensively in the EC's Financing for Development paper, a big difference to last years' Communication. The quite vague commitments on tax reform made last December at the Doha FfD summit, improvement of public financial management and combating tax evasion are welcomed, but this paper does not add much specificity. The Communication reviews how the EC and EU Member States support developing countries in raising domestic resources for development, including technical assistance, programs to reform customs administration, financial contributions to programs of relevant international organisations and cooperation with other international organisations. It points to the French-German initiative on uncooperative jurisdictions in tax matters launched in the run-up to the G20 summit, and the German "proposal" to create an International Tax Compact (which was launched in March).

Useful information is contained in the chapter on supporting an enabling international environment, where the current state of EU Member States' ratification and implementation of global agreements is analysed. Estonia has still not signed the UN Convention on Corruption, Italy and the Czech Republic have still not ratified it. Seven EU countries cannot access the OECD Convention on Bribery, only seven support the World Bank's Stolen Asset Recovery Initiative, and only eight the Extractive Industries Transparency Initiative.

EU rhetoric on enabling developing countries to raise taxes to improve development financing by using domestic resources still has to be matched by reality. The chapter on tax does not address the role of tax havens in the EU (and Member State overseas territories), as enabling factors for tax evasion in and capital flight from poor countries, it does not address Europe's contribution to the race to the bottom in corporate tax rates, and omits to reflect on the role which financial deregulation and liberalisation played to allow for tax evasion, imposed on developing countries by IFIs in which Europe plays a dominant role.

The European Network on Debt and Development is a specialist coordination of 55 NGOs working to analyse and influence development finance policies and practices. Further Eurodad analysis and subscription options for our fortnightly Development Finance Watch newsletter are available at www.eurodad.org.

⁸ Eurodad is working with the Counter-Balance alliance of NGOs to propose new EIB development policies. Contact Bodo Ellmers: [bellmers\[at\]eurodad.org](mailto:bellmers[at]eurodad.org).