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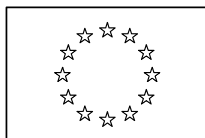

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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

The EU –- a global partner for development
Speeding up progress towards the Millennium Development Goals

The Monterrey process on Financing for Development - the European Union's contribution to Doha and beyond

Annual progress report 2008

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TABLE OF CONTENTS

Abbreviations 4

1. Introduction 6

2. The Doha Conference - focus on implementation, but new challenges and emerging issues not to be ignored 8

2.1. The EU priorities for Doha 8

2.2. The preparatory process 9

3. ODA levels: the EU continues to shoulder the lion's share of global scaling-up of aid10

3.1. Aid levels remained high in 2007 11

3.2. EU aid to Africa on the increase 13

3.3. The EU is overall on track to meet the 2010 milestone targets, but many Member States have yet to underpin their pledge by sustained action 17

3.3.1. Timetables for year-on-year aid increases have to be more widely established in Member States to help them meet the 2010 individual milestone targets 18

3.3.2. Is the forecast collective EU target of 0.56% ODA/GNI still in reach? 21

3.4. Uncertainty about future aid flows remains a major challenge 22

3.4.1. The challenges for the donor community 22

3.4.2. The challenges for developing partner countries 23

4. Implementing innovative sources of financing for new challenges, namely for climate change 26

4.1. Mobilisation of innovative finance for climate change mitigation and adaptation - an urgent challenge 26

4.2. A small number of EU Member States is promoting innovative sources and instruments 27

4.3. Policy recommendations 29

5. New challenges to debt sustainability in developing countries 29

5.1. The implementation of the HIPC initiative and the challenge of preserving debt sustainability 29

5.2. Policy recommendations 31

6. Global Public Goods (GPGs) 32

6.1. EU trends for investing in global funds and partnerships 32

6.1.1. Using allocative criteria to invest in Global Funds and Partnerships 32

6.1.2. Investment trends 33

6.1.3. Supporting a country-led approach 33

6.2. European co-ordination mechanism for contributions to Global Funds and Partnerships 33

6.3. Recommendations 33

7. Compensatory finance schemes: a necessary instrument of development policy to deal with exogenous shocks 34

7.1. Disaster Preparedness 34

7.2. Compensatory finance 35

7.3. Recommendations 37

8. Reform of the International Financial Institutions 38

8.1. Options for strengthening the voice and representation of developing and transition countries at the World Bank 38

8.2. Overall very positive, but differentiated assessment of the EU coordination at the IMF, the World Bank and regional development banks 39

8.3. The way forward 40

Annex 1: EU commitments on financing for development 41

Annex 2: The Commission's monitoring mandate and the methodology used for the preparation of this progress report 45

ABBREVIATIONS

ACP: African, Caribbean and Pacific States, party to the Cotonou Agreement
AFT: Aid for Trade
AMC: Advance Market Commitment
AT: Austria
BCPR: United Nations Development Programme's Bureau for Crisis Prevention and
BE: Belgium
BG: Bulgaria
CY: Cyprus
CZ: Czech
DAC: Development Assistance Committee of the OECD
DE: Germany
DK: Denmark
DRR: Disaster risk reduction
DRRP: Disaster Risk Reduction Prevention
DSF: Debt Sustainability Framework
EC: European Community
EDF: European Development Fund
EE: Estonia
EIB: European Investment Bank
EL: Greece
EPA: Economic Partnership Agreement
ES: Spain
ETS: Emission Trading Scheme
EU-27: European Union
FAO: Food and Agriculture Organisation
FI: Finland
FLEX: The EU instrument to compensate African, Caribbean and Pacific (ACP) countries for short term fluctuations in export earnings
FR: France
FFD: Financing for Development
FSF: Financial Stability Forum
G 8: Group of Eight (Summit of Canada, France, Germany, Italy, Japan, Russia, United Kingdom and United States)
GCCA Global Climate Change Alliance
GDP: Gross Domestic Product
GEEREF: Global Energy Efficiency and Renewable Energy Fund
GFDRR: Global Facility for Disaster Risk Reduction
GIIF: Global Index Insurance Facility
GNI: Gross National Income
GPG: Global Public Goods
HIPC: Heavily Indebted Poor Countries
HU: Hungary
IE: Ireland
IFF: International Financial Facility
IFFI: International Finance Facility for Immunisation
IFI: International financial institution
IMF: International Monetary Fund

IPG: International Public Goods
ISDR: International Strategy for Disaster Reduction
IT: Italy
LDC: Least Developed Countries
LT: Lithuania
LU: Luxembourg
LV: Latvia
MDG: Millennium Development Goals
MDRI: Multinational Debt Relief Initiative
MoU: Memorandum of Understanding
MS: Member States
MT: Malta
NGO: Non-Governmental Organisation
NL: The Netherlands
ODA: Official development assistance
OECD Organisation for Economic Cooperation and Development
PGA: President of UN General Assembly
PL: Poland
PT: Portugal
RO: Romania
SE: Sweden
SI: Slovenia
Stabex: French Système de Stabilisation des Recettes d'Exportation
Sysmin: Special assistance measure for the ACP mining
SK: Slovakia
UK: United Kingdom
UN: United Nations
UNGA: United Nations General Assembly
UNCHR: United Nations Commission on Human Rights
UNDP: United Nations Development Programme
UNFCCC: United Nations Framework Convention on Climate Change
UNITAID: International Drug Purchase Facility
UNSC: United Nations Security Council
WB: World Bank
WFP: World Food Programme
WHO: World Health Organisation

WTO: World Trade Organisation

1. INTRODUCTION

The EU has led the global effort to increase aid flows to developing countries since Monterrey. The Doha Follow-up International Conference on Financing for Development (FFD) to Review the Implementation of the Monterrey Consensus scheduled for the end of 2008 presents a credibility test, as Europe's contribution to implementing the progressive development policies outlined at Monterrey will be under close scrutiny. The conference aims to evaluate progress and find ways to face new challenges and emerging issues.

The EU continues to shoulder the lion's share of global aid commitments and of pledges to Africa. In 2007 the enlarged EU of 27 countries mobilised again large amounts of Official Development Assistance (ODA) equivalent to around €93 per European citizen to support developing countries in achieving the Millennium Development Goals (MDGs). While global aid levels need to grow further, donor and developing partner countries also have to ensure that aid delivery becomes more predictable and effective. The EU is at the forefront of the international Financing for Development process and the aid effectiveness agenda; the Union went beyond the Paris Declaration and moved to joint multi-annual strategic planning and is now implementing the EU Code of Conduct on Division of Labour in Development Policy.

2007 has been a difficult year for many Member States that could not cushion the expiry of the "one off" ODA-able effects of debt relief measures, initiated in previous years, by higher "fresh" ODA disbursements. Overall trends are as follows:

- EU aid decreased from from €47.7 billion in 2006 (corresponding to 0.41% of the EU's collective Gross National Income (GNI)) in 2006 to to €46 billion in 2007 (equivalent to 0.38% in 2007). While the 15 EU countries, which had pledged to achieve together, by 2006, a minimum of 0.39% by 2006, remained above that level (0.40%), the overall collective EU result is below that collective target.

- The decrease of aid volumes is expected to be transitory. If Member States' forecasts for 2008 hold true, aid levels should attain again a record high this year.

- The share of "programmable aid" in total EU ODA has increased, indicating that the debt relief spike is over.

- EU ODA, if expressed in US dollar, increased from $60 billion to $63 billion. This trend, resulting from the appreciation of the Euro vis-à-vis most other currencies including the US-dollar, generates more than an accounting effect; it implies that one Euro could buy more aid in countries whose currencies depreciated against the Euro.

- EU aid to Africa is on the increase: in 2005 the EU pledged to collectively direct 50% of aid increases to Africa, largely contributing to the G8 pledge to channel an additional US$ 25 billion per year to the continent by 2010 compared to 2004 levels. From 2005 to 2006 the EU mobilised an additional €3.7 billion, an amount higher than the total increase in EU aid over that period. There is, moreover, a

strong commitment by half of those Member States that together provide 80% of Europe’s ODA to individually contribute to achieving the common goal.

- Most Member States are considered “on track” to achieve the 2010 individual milestone target of 0.51% ODA/GNI. Some Member States that had fixed more ambitious national targets to achieve the 0.7% ODA/GNI goal have decided to slow down the scaling-up, by postponing the target date to 2015 (France, Finland) or by back-loading the scaling-up (United Kingdom). It will therefore be difficult for the EU to attain the 2010 collective intermediate target of 0.56% ODA/GNI. This development also impinges on the prospect for the Union to reach the 0.7% target by 2015, because efforts to scale up aid have to be further reinforced in the period beyond 2010.

Further progress in the Financing for Development process requires key challenges to be addressed:

- **Reinvigoration of the EU efforts to ensure increasing aid levels again as of 2008** in the run-up to meeting agreed EU ODA targets by 2010 and 2015;

- **Fair burden-sharing between donors of the scaling-up of aid**: There is a widening gap between the EU and other donors, namely the non-EU G8 countries, in their contribution to common goals. Within the EU those Member States that lag furthest behind in living up to their individual commitments have to demonstrate the political will to move away from persistently low aid levels towards meeting the agreed ODA targets.

- The high **volatility and fragmentation of aid** flowing from an ever-increasing number of actors and funds is a major impediment to the effective use of aid by beneficiary countries. Donors have to revert to the available tools to reinforce aid predictability (such as timetables for annual ODA increases, long-term strategic planning, multi-annual commitments, aligned aid delivery mechanisms such as budget support, division of labour) to enhance the impact and effectiveness of their aid.

- **Financing of new challenges** – such as mitigation of and adaptation to climate change in response to worsening climate conditions - are hampering developing countries' efforts to reach the Millennium Development Goals. Enhanced action by the international community is necessary to help these countries to continue their path towards development. This includes integrating mitigation and adaptation considerations into development assistance as well as developing tools with which to screen projects for climate risks.

- **Long-term debt sustainability** for developing countries must not be undermined by **“free-riding”** of commercial and public lenders that have not contributed to alleviating the debt burden of poor countries under the various debt relief initiatives. Engaging into new lending may again jeopardise debt sustainability in countries that had benefited from debt relief.

This report supplements the Communication "The EU – a global partner for development – Speeding up progress towards the Millennium Development Goals". It is the Commission's sixth annual assessment of Europe's delivery on ten

commitments that were made to improve the Financing for Development in the spirit of the 2002 Monterrey Consensus. The report presents an evaluation of how Europe has moved from rhetoric to reality since that year. The report builds on and assesses the opinions of the 27 Member States (EU-27) expressed in their replies to the monitoring questionnaire of late 2007 ("Monterrey survey 2008"). Individual profiles of the Member States and the Commission are being prepared to reflect the positions they expressed in the survey.

The ten EU thematic commitments relate to the volume and sources of financing for development and the quality of aid, i.e. ODA volumes, innovative sources of financing, more predictable and stable aid mechanisms, debt relief, aid effectiveness, the untying of aid, the mitigation of exogenous shocks, aid for trade, the reform of the international financial institutions and Global Public Goods (overview in Annex 1).

In line with the Council's request that progress in implementing the EU Code of Conduct on Division of Labour in Development Policy and the EU Aid for Trade implementation strategy be assessed in the context of the annual Monterrey report, this document is complemented by the Staff Working Paper "An EU aid effectiveness roadmap to Accra and beyond" and the "Aid for Trade Monitoring Report 2008"[1].

2. THE DOHA CONFERENCE - FOCUS ON IMPLEMENTATION, BUT NEW CHALLENGES AND EMERGING ISSUES NOT TO BE IGNORED

In line with UN General Assembly (UNGA) Resolutions 61/191 of 20 December 2006 and 62/187 of 19 December 2007 the Commission considers that the Doha Follow-up International Conference on Financing for Development (FFD) to Review the Implementation of the Monterrey Consensus that will take place in late 2008 should assess progress made, reaffirm goals and commitments, share best practices and lessons learned and identify obstacles and constraints encountered, actions and initiatives to overcome them and important measures for further implementation, as well as new challenges and emerging issues.

2.1. The EU priorities for Doha

The UN co-facilitators of the FFD process decided that in the preparatory process for the Doha Conference emerging issues are to be addressed in the context of each review session, rather than through separate sessions. For the **EU** it is important to underline that this approach confirms maintaining the integrity of the **Monterrey Consensus**, which is **not to be renegotiated, while the impact of new challenges and emerging issues to the implementation of the Consensus needs to be considered**.

The three challenges/emerging issues that were ranked as being the most relevant ones by the Member States in the Monterrey survey 2008 were **climate change** (18 Member States), **aid predictability** (13), **emerging donors** (12) **and multiplication**

[1] SEC(2008) 435 "An EU Aid Effectiveness Roadmap to Accra and beyond - From rhetoric to action, hastening the pace of reforms"; SEC(2008) 431 "Aid for Trade monitoring report 2008".

of actors and funds, e.g. the role of private donations through philanthropic foundations and **remittances** (nine Member States). The last two issues both belong to the more general challenge of the **New Global Aid Architecture**. The EU should promote discussion of these issues in the run-up to Doha as well as during the negotiations.

Effective implementation of the Monterrey Consensus by both developing countries and the international community is essential to our joint development efforts in order to reach the MDG and other internationally agreed development goals and targets. The outcome of the Doha Conference has to reflect in a balanced way

- the respective responsibilities and commitments of both donors and developing countries and

- ODA volumes and equally other crucial aspects of financing for development, i.e. mobilisation of domestic resources and foreign direct investment, good governance, aid predictability, aid effectiveness, external debt and international trade.

2.2. The preparatory process

The President of the UN General Assembly (PGA) has drawn up a two-stage Work Programme for the UN's preparations for Doha:

- The first part of the process will rest on six preparatory review sessions covering the six chapters of the Monterrey Consensus, which have been scheduled between February and May 2008 in New York. This will be supplemented by hearings with civil society and the business sector in June. The outcome of the review sessions will influence the second part of the process.

- The UNGA enabling resolution 62/187 stipulates that the Doha Conference will result in an internationally agreed outcome. The nature of the outcome document – a first draft is to be available by July - remains to be determined. Negotiations on the outcome document will most likely start in the second part of September. By that time the results of the Third High Level Forum on Aid Effectiveness in Accra and of the MDG High Level Event, envisaged in the framework of the Ban Ki-Moon's "MDG Africa-Steering Group" will be known and hence feed into the Doha process.

Doha will be an event of particular importance for the EU, which is actively contributing to its preparation through a series of EU Background Papers on the Monterrey Consensus chapters. These short documents are for wide distribution by the EU Presidency in New York to make the current EU policies, positions, initiatives and actions known to our partners. The EU Background Papers will also serve as a reference for EU participants in the preparatory sessions, thus ensuring that EU statements are coherent and mutually reinforcing.

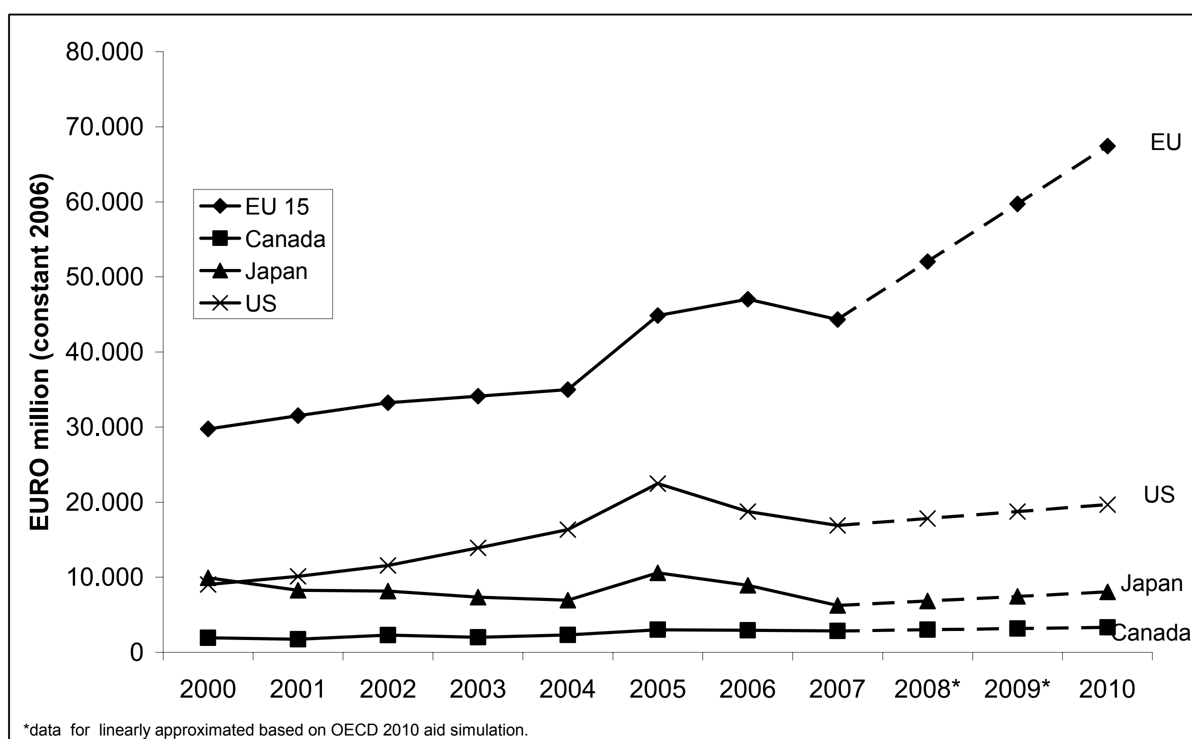
In line with the nature of the Doha Conference reviewing the implementation of the Monterrey Consensus, the EU feels a ministerial level participation in Doha to be appropriate, with preferably a Ministerial Declaration as an outcome. In accordance with the UNGA resolution 62/187, the EU expects the modalities of the Monterrey

Conference to apply to facilitate civil society and private sector participation in the Doha Conference, as well as to allow the European Community to fully participate.

3. ODA LEVELS: THE EU CONTINUES TO SHOULDER THE LION'S SHARE OF GLOBAL SCALING-UP OF AID

Europe is far ahead of the other G8 donors in attaining the 2005 commitment to increase aid by US$50 billion from 2004 levels, reaching US$130 billion in 2010. OECD simulations show that the EU will contribute more than 90% of the remaining aid volumes that need to be mobilised in real terms in the period 2006 to 2010 to meet commitments (€20.4 billion out of €22.3 billion). European aid is expected to increase by 43% during this time period, in contrast with US aid, which is expected to grow by only 5%, Canadian aid, which will increase by 14%, and Japanese aid, which is forecast to drop by 10%.

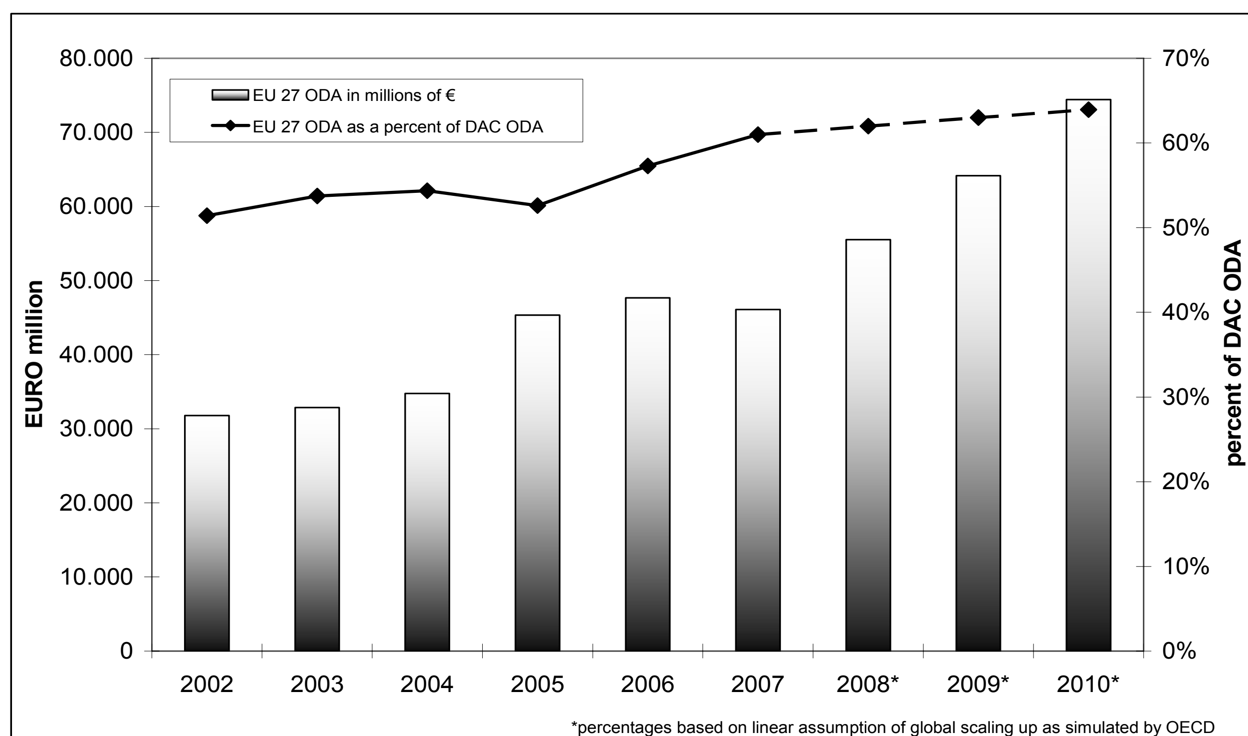
Figure 1: Global aid flows 2000 – 2010 (in € million constant 2006)



Source: European Commission calculations on OECD/ DAC data.

If disbursements confirm the latest projections and all Member States deliver on agreed ODA targets the EU share in global ODA will grow to represent two thirds of global ODA by 2010. This will require the demonstration of significant political will, underpinned by corresponding national policy decisions in aid budgeting in 2008 and beyond. Only then will Europe remain credible and be able to keep up its reputation for being the world's most generous and progressive donor.

Figure 2: EU aid levels 2000 – 2010
(in € million current prices and as percent of DAC ODA)



European Commission simulation on OECD/ DAC data and on EU Member States' information provided in the context of the Monterrey questionnaire 2008

3.1. Aid levels remained high in 2007

Despite overall disappointing aid volume results the EU together maintained its lead role as the world's largest aid donor. Nevertheless, 2007 did see the first decrease in development finance in Euro terms since the adoption of the EU's aid commitments of 2002. European aid levels dropped from 0.41% ODA/GNI in 2006 to 0.38% ODA/GNI, with overall ODA amounts falling by around €1.5 billion in 2006 to €46 billion last year. As a result of the appreciation of the Euro vis-à-vis most other currencies in 2007, EU ODA expressed in US dollars was significantly higher than in 2006. This is more than an accounting effect as it implies that the EU was able to deliver more aid for the same amount of Euros in countries where project costs are billed in other currencies than the Euro. The following factors meant that the EU could not improve its excellent result of 2006:

- Those Member States that had missed the 0.33% ODA/GNI minimum individual target in 2006 fell further behind, decreasing their aid further from already low levels (Greece, Italy and Portugal).

- Several Member States with a high share of debt relief in their ODA of previous years were unable to adapt their ODA budgets in time to ensure that aid continued to increase immediately after the end of the debt relief spike (namely the UK, France and Belgium). The UK's and France's higher than expected aid levels in 2005 and 2006 (due to speedy debt relief implementation), resulted in a sharp decrease in ODA in 2007.

- The integration into the EU of the two new Member States Bulgaria and Romania with relatively big economies and very low ODA levels as well as continued high economic growth in the EU also impeded an improvement of Europe's collective aid levels as a share of GNI.

Table 1: EU ODA levels 2004 – 2007

	2004		2005		2006		2007	
	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI
Austria	546	0,23	1.266	0,52	1.193	0,47	1.313	0,49
Belgium	1.178	0,41	1.580	0,53	1.576	0,50	1.427	0,43
Bulgaria	NA	NA	NA	NA	1	0,00	16	0,06
Cyprus	4	0,03	12	0,09	21	0,15	18	0,12
Czech Republic	87	0,11	109	0,11	128	0,12	131	0,11
Denmark	1.639	0,85	1.697	0,81	1.782	0,80	1.872	0,81
Estonia	4	0,04	8	0,07	12	0,09	17	0,12
Finland	547	0,37	726	0,46	664	0,40	711	0,40
France	6.820	0,41	8.067	0,47	8.446	0,47	7.261	0,39
Germany	6.064	0,28	8.112	0,36	8.314	0,36	8.961	0,37
Greece	258	0,16	309	0,17	338	0,17	366	0,16
Hungary	56	0,07	80	0,10	119	0,13	66	0,07
Ireland	489	0,39	578	0,42	814	0,54	869	0,54
Italy	1.982	0,15	4.096	0,29	2.901	0,20	2.870	0,19
Latvia	7	0,06	8	0,07	10	0,06	12	0,06
Lithuania	8	0,04	12	0,06	18	0,08	30	0,11
Luxembourg	190	0,83	206	0,86	232	0,84	266	0,90
Malta	8	0,18	8	0,18	7	0,15	8	0,15
The Netherlands	3.384	0,73	4.116	0,82	4.344	0,81	4.540	0,81
Poland	95	0,05	165	0,07	239	0,09	260	0,09
Portugal	830	0,63	303	0,21	315	0,21	294	0,19
Romania	NA	NA	NA	NA	3	0,00	80	0,07
Slovak Republic	23	0,07	45	0,12	44	0,10	49	0,09
Slovenia	25	0,10	29	0,10	35	0,12	40	0,12
Spain	1.962	0,24	2.428	0,27	3.039	0,32	4.196	0,41
Sweden	2.191	0,78	2.706	0,94	3.151	1,02	3.166	0,93
UK	6.339	0,36	8.666	0,47	9.932	0,51	7.247	0,36
EU 15 TOTAL	34.418	0,35	44.857	0,44	47.040	0,43	45.361	0,40
EU 10/12 TOTAL	316	0,07	479	0,08	637	0,09	726	0,09
EU 25/27 TOTAL	34.735	0,33	45.336	0,41	47.676	0,41	46.087	0,38

EU 25/27 ODA in USD	43.156	56.344	59.839	63.090

Source: OECD/DAC for 2002 – 2006; Commission data based on Member States information to the Commission or the DAC for 2007; shaded cells contain information supplied by Member States, white cells are Commission data or simulations. ODA is at current prices.

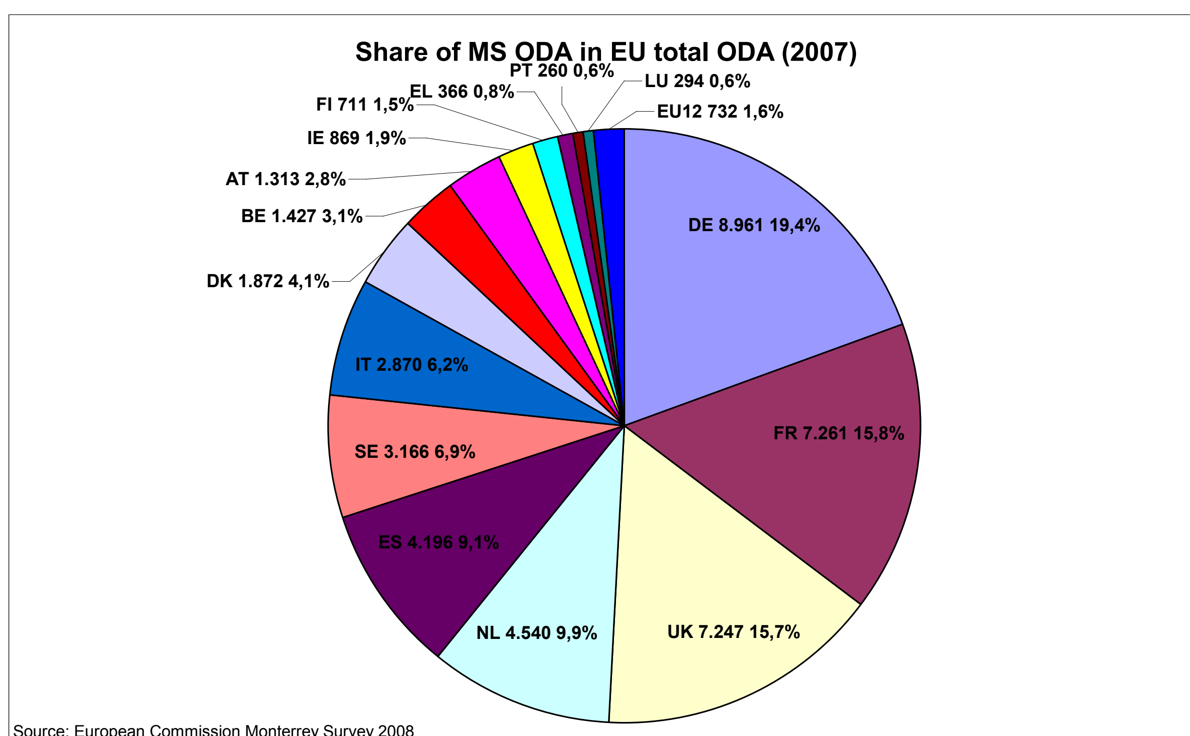
There was also significant good news from some Member States that allowed the EU to contain the decrease of its collective result:

- **Denmark, the Netherlands** and **Sweden** maintained substantially higher aid levels than the 0.7% EU target. Luxembourg advanced on its national path to disburse 1% of its GNI for aid in the future reaching 0.90% ODA/ GNI for the first time, while Sweden maintained its lead position within the EU albeit missing the national 1% target.

- **Spain** has to be lauded for continuing its impressive path of scaling-up, mobilising additional €1.2 billion – more than any other Member State in that year - and reaching 0.41% ODA/GNI, thus largely exceeding the 0.33% individual EU minimum target that it had missed by a small margin in 2006.

- **Germany**, with € 8.9 billion the EU's biggest individual donor country in 2007, also demonstrated continuing political will to increase aid further and attained 0.37% ODA/GNI. However, the pace of increase has to be significantly reinforced to ensure that Germany will meet the EU individual baseline target of 0.51% ODA/ GNI by 2010.

Figure 3: Percentage share of Member States in EU ODA in 2007



Source: DAC data and European Commission sources (Monterrey survey 2008)

3.2. EU aid to Africa on the increase

Africa is the continent least likely to meet the Millennium Development Goals by 2015. As Africa's biggest donor, Europe, therefore decided to focus the spending of additional ODA becoming available on this continent: in 2005 the EU pledged to channel 50% of collective aid increases to Africa, contributing to the G8 pledge to channel an additional US$25 billion annually to the continent by 2010 compared to 2004 levels. From 2005 to 2006 the EU has demonstrated the re-focusing of its aid, by directing an additional €3.7 billion (and reaching a total of €23.7 billion) to the

continent. This represented more than of its entire aid increases over that period (154 %). In 2006 the EU (Member States and the European Commission) gave together 62% of its bilateral, regionally allocated aid to Africa, up from 51% in 2005, and it provided more than half of the global aid flows to the region.

The Monterrey survey 2008 intended to check how far the EU's Africa commitment, which was only defined as a collective result, was underpinned by the readiness of individual Member States to provide at least half of their scaled up aid to the region and to contribute to the common goal.

The replies revealed that there is overwhelming support: 13 Member States that together mobilise almost 80% of Europe's aid declared that at least half of their aid increases will go to the continent[2] and almost all others confirmed their intention to increase ODA to Africa[3]; some Member States that are new donors highlighted their preference for focusing their bilateral development cooperation in other regions where they have accumulated expertise (namely in countries neighbouring the EU, the South Caucasus and Central Asia) and contributing to Europe's support to Africa through the EC budget and the European Development Fund.

If all the Member States manage to keep their commitments, the EU may well provide more than 90% of the G8's US$25 billion pledge for Africa over the period 2004-2010, increasing aid in real terms by more than €18 billion per year in 2010 (and €24 billion in nominal terms)[4].

Most EU countries will channel additional funds to Africa through bilateral aid to individual countries in project mode (22 out of 27) and through budget support (10 out of 27). Contributions to multilateral trust funds (15 out of 27) are also a favoured way to increase aid to Africa.

In many African countries, inflows of foreign aid have a size of macroeconomic significance, sometimes reaching a double-digit percentage relative to GDP. In light of the weak growth performance of many African countries until recently, growth effects of aid and possible limits to macroeconomic absorption capacity need to be tackled (see box 1 below). Aid can have substantially positive growth effects when the right policies are put in place.

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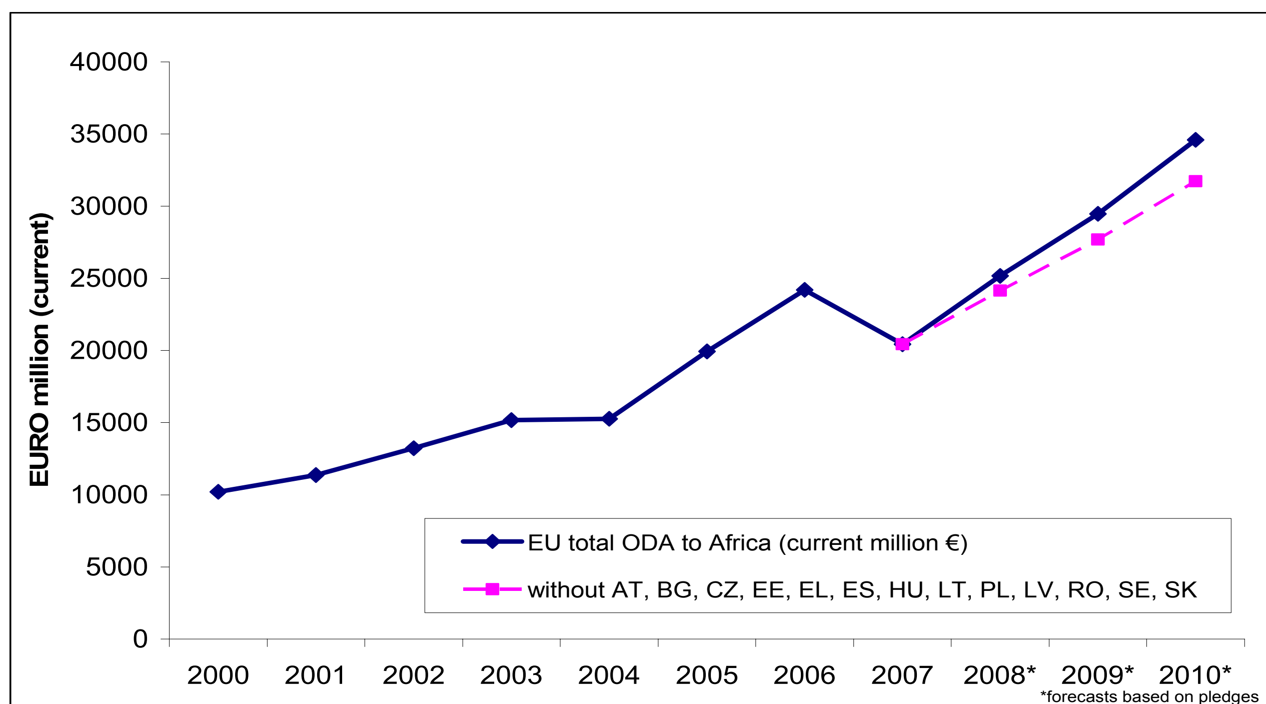
2 BE, DE, DK, FI, FR, IE, IT, LU, MT, NL, PT, SI, UK.

3 AT, BG, EE, ES, HU, LT, LV, PL, SE

4 Even if AT, EL, ES, SE and others would not disburse any additional aid to Africa (which is unlikely) Europe will still be covering more than 80% of the G8 pledge.

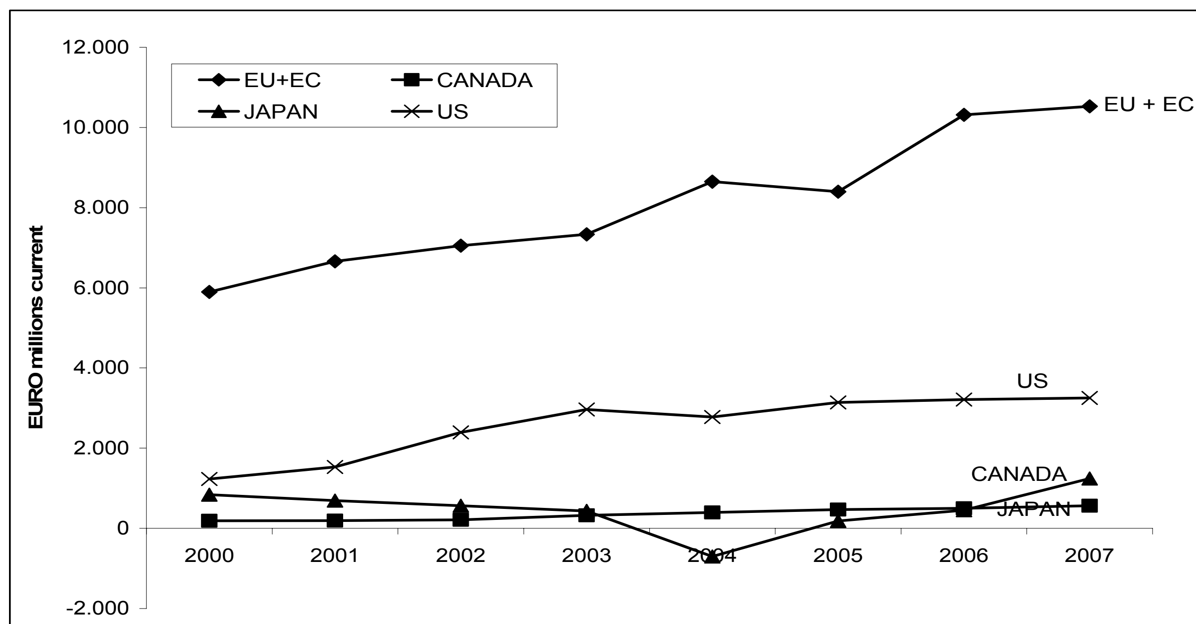
Figure 4: EU ODA to Africa (in € current million) including debt relief grants



For this simulation it was assumed that the 14 Member States that together provide 20% of total EU ODA would not at all increase their ODA to Africa. The 2007 data point is based on an extrapolation that imputed multilateral aid to Africa will remain at 30% of total aid to Africa as it did in 2006.

The following figure shows that the increase of EU aid to Africa is "real" and not only a consequence of debt relief.

Figure 5: Bilateral ODA increase to Sub-Sahara Africa without debt relief grants



Source: OECD/ DAC

Box 1: The nexus of aid, absorptive capacity and growth

The Monterrey Consensus recognises that ODA is an important financial source for development, alongside domestic resource mobilisation, mobilisation of foreign direct investment and other international private flows such as international trade. For these financial flows to propel a partner country out of poverty, the principle of mutual accountability must be respected, and aid needs to be accompanied by increases in domestic savings, income equality, and good governance within the partner country. There is wide consensus that ODA, if well managed, can be very effective at the micro-economic (or project) level. Views are more divergent regarding the macro-economic effects of aid on long-term growth:

- *Some empirical economic research indicates a "micro-macro paradox" in that successful projects in a given country can go along with little or no economic growth effects. Since long-term growth is essential for poverty eradication these findings shed doubt on the efficiency of aid.*

- *Other development research criticises the applied methodologies underpinning the above finding for having a number of inherent weaknesses (country experience too specific to be pooled into one dataset for statistical estimates; used aid data may neglect the wide variety of types of aid or the fact that there may be diminishing returns to aid; underlying assumptions on the additionality of aid do not correspond to reality).*

More basic economic estimations of the aid impact on growth suggest that aid may be more effective when countries are poorest. However, recent empirical studies found an increased effectiveness of aid in good policy environments which could mean that aid may become more effective in a later stage of development. However, many of these empirical results have proved fragile in terms of the robustness of model specifications. Nevertheless, there is evidence that once aid flows disbursed for political or humanitarian reasons (short-impact aid) are excluded, a positive net effect on economic growth is observed for the remaining aid (long-impact aid, e.g. aid to build infrastructure or to support productive sectors as well as budget support).

In the light of the large aid increases pledged since 2002, research has also looked at possible limits to the absorptive capacity of developing countries vis-à-vis growing aid inflows. Like other investments, aid has diminishing returns after a certain saturation point that will vary greatly from country to country. The OECD/DAC recently stated that "the best growth performance recently has been in developing countries, allaying many fears about hitting absorptive capacity ceilings."

Donors must strike a balance between rewarding those countries with good policy environments, and recognising the absorptive capacity limits of these donor darlings, as such countries have had to limit their absorption in the face of volatile aid surges, choosing instead to build reserves. Increasing aid predictability and reducing aid volatility is important for monetary and fiscal policy to absorb and spend aid for poverty reduction without jeopardising macroeconomic stability and growth. Transparent and binding multi-annual country-specific commitments from donors are crucial in this respect. This would also help donor coordination avoid peaks and troughs of aid over time or across countries. Giving priority to spending in areas that increase potential growth, notably in infrastructure and human capital, will help to increase the absorption capacity.

Further research is needed to get more robust evidence since available results point to the need of appropriate policy measures to ensure that aid has positive effects on long-term economic growth.

Sources:

Burnside, C., Dollar, D. (2000) "Aid, Policies and Growth". Washington DC. World Bank.
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Clemens, M.A., Radelet, S., Bhavnani, R., (2004) "Counting chickens when they hatch: The short-term effect of aid on growth". International Finance 0407010 Econ WPA.

Overseas Development Institute (2007) Budget support and beyond: Can the Paris Agenda on aid be delivered? CAPE Workshop Report pg 4. London.

3.3. The EU is overall on track to meet the 2010 milestone targets, but many Member States have yet to underpin their pledge by sustained action

In 2005 the EU committed to additional aid targets, aiming to reach individually 0.51% ODA/GNI (EU-15) and 0.17% ODA/GNI (EU-12) by 2010, while those countries that have already achieved high aid levels promised to maintain them. Collectively, the EU should reach 0.56% ODA/GNI by 2010. Based on higher national pledges of some Member States it was assumed that the collective result could be in the order of 0.56% ODA/ GNI.

Table 2: ODA estimates 2007 – 2013

	2007		2010		2011		2012		2013	
	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI	ODA in million €	ODA in % of GNI
Austria	1.313	0,49	1.552	0,51	1.613	0,51	1.675	0,51	1.974	0,58
Belgium	1.427	0,43	2.669	0,70	2.711	0,68	2.818	0,68	2.974	0,69
Bulgaria	16	0,06	68	0,17	95	0,22	122	0,25	149	0,29
Cyprus	18	0,12	28	0,15	33	0,17	36	0,18	41	0,19
Czech Republic	131	0,11	155	0,10	352	0,21	434	0,25	516	0,28
Denmark	1.872	0,81	2.109	0,80	2.222	0,80	2.288	0,80	2.377	0,80
Estonia	17	0,12	35	0,16	42	0,17	63	0,23	84	0,27
Finland	711	0,40	1.067	0,51	1.113	0,51	1.231	0,54	1.419	0,60
France	7.261	0,39	10.810	0,51	12.211	0,55	13.613	0,60	15.015	0,63
Germany	8.961	0,37	13.798	0,51	15.531	0,55	17.264	0,60	18.997	0,63
Greece	366	0,16	1.076	0,39	1.313	0,45	1.550	0,51	1.757	0,55
Hungary	66	0,07	182	0,17	236	0,21	290	0,24	345	0,28
Ireland	869	0,54	1.139	0,60	1.283	0,64	1.477	0,70	1.558	0,70
Italy	2.870	0,19	8.706	0,51	9.822	0,55	10.939	0,60	12.055	0,63
Latvia	12	0,06	20	0,07	76	0,22	102	0,27	127	0,30
Lithuania	30	0,11	67	0,17	75	0,17	93	0,19	134	0,25
Luxembourg	266	0,90	358	0,93	391	0,94	426	0,95	470	0,97
Malta	8	0,15	10	0,17	21	0,33	21	0,33	22	0,33
The Netherlands	4.540	0,81	5.245	0,80	5.478	0,80	5.691	0,80	5.913	0,80
Poland	260	0,09	679	0,17	889	0,21	1.099	0,24	1.309	0,28
Portugal	294	0,19	898	0,51	1.023	0,56	1.148	0,60	1.273	0,64
Romania	80	0,07	247	0,17	361	0,22	475	0,26	589	0,29
Slovak Republic	49	0,09	120	0,17	163	0,21	206	0,25	250	0,28
Slovenia	40	0,12	69	0,17	87	0,20	106	0,23	131	0,27
Spain	4.196	0,41	7.218	0,60	8.114	0,64	9.335	0,70	9.803	0,70
Sweden	3.166	0,93	3.875	1,00	4.029	1,00	4.179	1,00	4.330	1,00
UK	7.247	0,36	12.232	0,56	13.673	0,61	15.385	0,66	17.097	0,70
EU 15 TOTAL	45.361	0,40	72.752	0,57	80.507	0,61	89.019	0,64	97.012	0,67
EU 12 TOTAL	726	0,09	1.681	0,16	2.429	0,21	3.048	0,24	3.697	0,28
EU 27 TOTAL	46.087	0,38	74.432	0,54	82.936	0,57	92.067	0,61	100.709	0,64

Source: Shaded cells contain information supplied by Member States, white cells are Commission data or calculations. ODA is at current prices.

3.3.1. *Timetables for year-on-year aid increases have to be more widely established in Member States to help them meet the 2010 individual milestone targets*

The Monterrey survey 2008 endeavoured to track how Member States have prepared for implementing pledged aid increases to attain the 2010 milestone targets. In 2007 the Council had acknowledged the crucial role of year-on-year timetables to ensure gradually increasing aid levels and had encouraged Member States that have ODA levels below the targets to establish national timetables by the end of 2007. While Denmark, Ireland, Luxembourg, the Netherlands and Sweden are not concerned by the call for timetables as their aid is at or above aid levels, timetables have become an issue of political debate in most Member States, which have adopted different approaches to tackle the issue: e.g. through multi-annual budget planning or development policy documents or in the context of preparing OECD/ DAC membership. Concrete overall progress so far has been mixed:

- Eight Member States have government-wide agreed policy documents containing a timetable that leads to achieving agreed EU – or more ambitious national – ODA targets, i.e. Belgium, Cyprus, Estonia, Finland, Romania, Slovenia, Spain and the United Kingdom.

- In other countries inter-ministerial work is ongoing towards establishing timetables (i.e. in Austria, Greece, Hungary, Poland) or parliamentary endorsement is pending (Italy).

- Several Member States do not mention any intentions regarding year-on-year timetables, i.e. Bulgaria, France, Germany, Lithuania, Malta, Portugal and Slovakia, while a last group seems to have decided to restrict the scaling-up implying that by 2010 aid amounts will be insufficient by a wide margin to approach pledged ODA levels (Czech Republic, Latvia).

The “ODA indicator”-figures 6 and 7 hereafter attempt to evaluate the current preparedness of Member States with regard to attaining the individual EU 2010 ODA targets. The following criteria – focussing on the longer-term preparedness - have been used for assessing how far countries are “on track”: (1) current ODA levels that already correspond to or exceed the 2010 goals; (2) current ODA levels at or above the 2006 minimum goal of 0.33% (for the EU15); (3) availability of government-wide agreed timetables. In contrast, while the figures indicate the upward or downward move of ODA in 2007 that year’s result is considered transitory and not decisive for the overall evaluation.

Figure 6: The ODA-target indicator: Are the EU Member States on track towards meeting agreed ODA targets? The EU15 Member States:

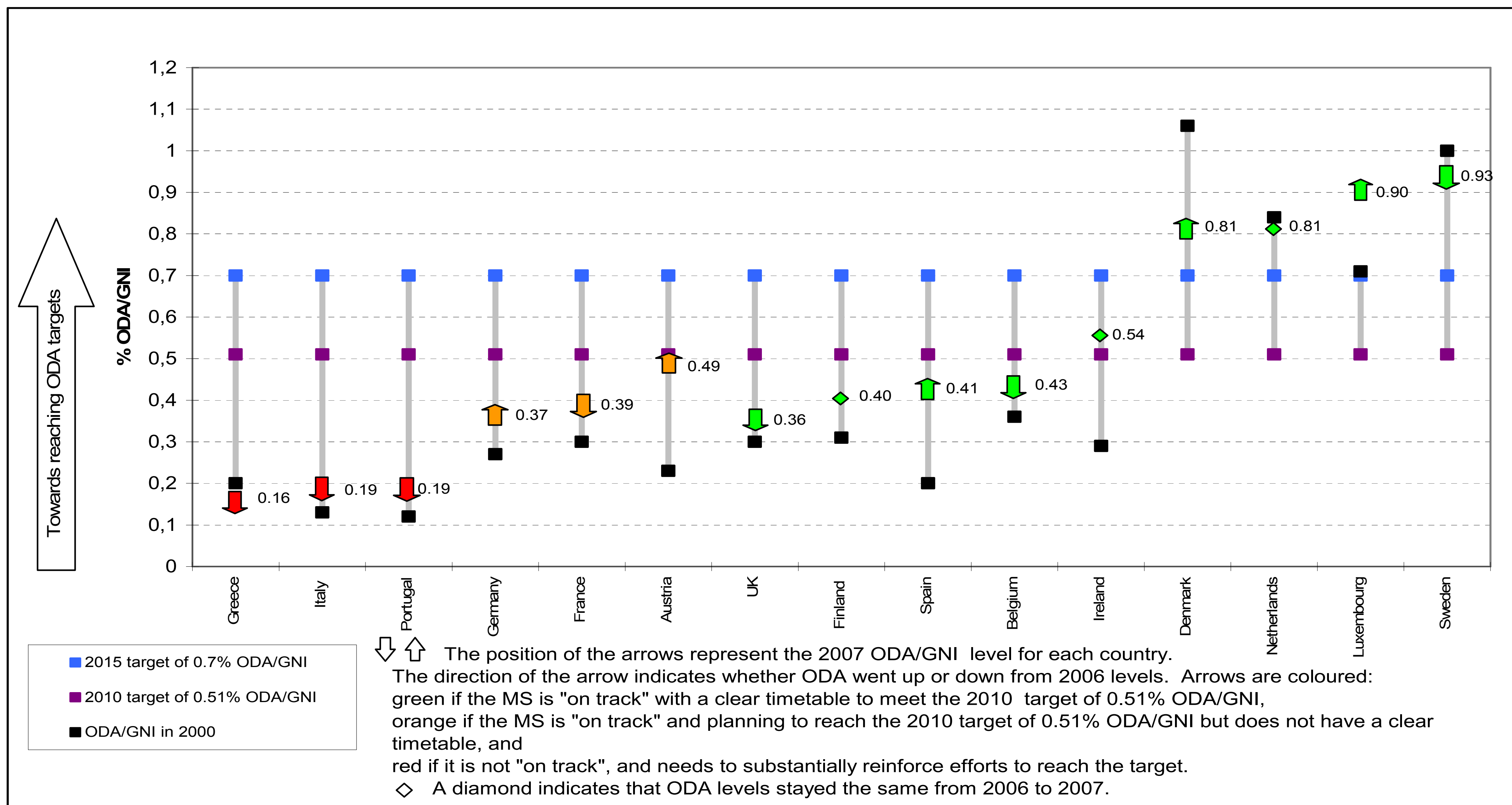
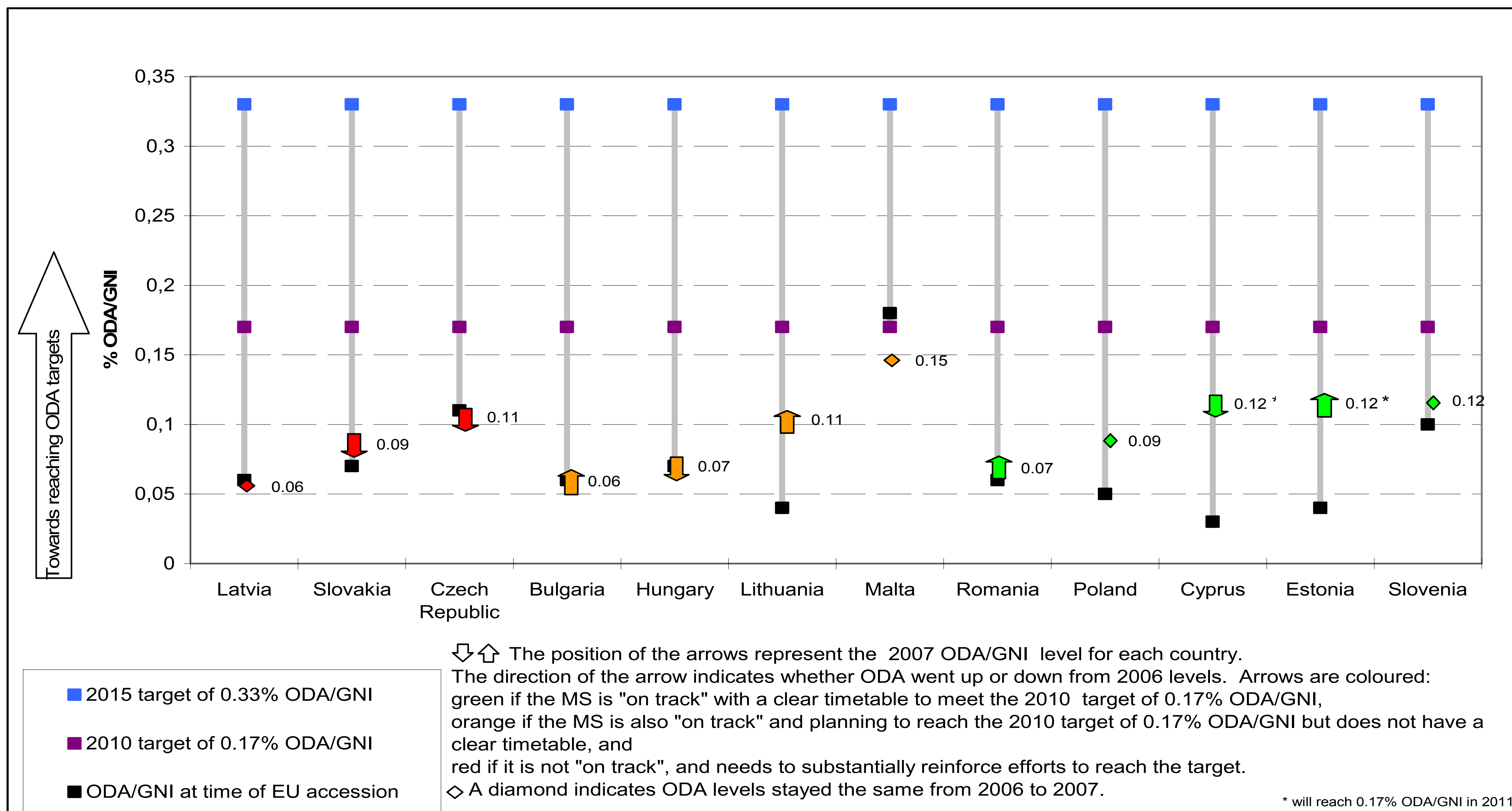


Figure 7: The ODA-target indicator: Are the EU Member States on track towards meeting agreed ODA targets? The EU12 Member States:



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3.3.2. *Is the forecast collective EU target of 0.56% ODA/GNI of 2010 still in reach?*

The "off-track" situation of some Member States and the decision of others to slow-down the scaling-up makes it increasingly difficult for the EU to achieve earlier forecast collective results in 2010.

Despite the excellent performance of Denmark, Ireland, Luxembourg, the Netherlands and Sweden, current aid estimates indicate that the collective EU target of 0.56% ODA/GNI by 2010 agreed by the Council in 2005 may not be met. Europe relies not only on the medium-sized donors, but also on EU countries with large economies such as France, Germany, Italy and the UK to boost average aid levels so as to reach targets. If Europe is to meet the collective target of 0.56% ODA/GNI by 2010, it is imperative that big players too exceed this level at that date. However, some countries with more ambitious national ODA goals have revisited their national commitments in 2007, slowing down or back-loading aid flows: Finland and France have pushed back the 0.7% target to 2015 aligning their national efforts downwards to the EU timetable. The United Kingdom, while maintaining the year 2013 for reaching 0.7% ODA/ GNI, will pursue a multi-annual budget schedule that entails back-loading the scaling up. Greece is drawing conclusions from the fact that it will not be able to move away from low aid levels and indicated that 0.51% will not be achieved prior to 2012.

EU countries that have still not reached the 2006 targets and those that have not prepared for reaching 2010 milestones need to demonstrate better political will to bridge the **increasing gap** in the spirit of securing **fair burden-sharing between Member States**.

An EU linear ODA increase over the period 2006 – 2010 would have allowed 0.43% ODA/GNI to be reached in 2007. Not attaining this level, and falling back to 0.38% means that €5 billion in ODA has not become available for partner countries. The aggregate loss for no linearly scaling up towards the 0.56% ODA/GNI target from 2006 to 2010 could correspond to more than €17 billion.

Table 3 shows that aid disbursements in 2007 by several Member States remained considerably below forecasted aid levels, sometimes in contrast to existing national timetables: e.g. ODA disbursements in 2007 were equivalent 0.43% ODA/GNI for Belgium, 0.16% for Greece (0.42% for France), 0.19% for Portugal and 0.36% for the United Kingdom.

Table 3:
EU and national timetables to attain ODA/GNI targets

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
EU 15 target	**0.39%**	→	→	→	**0.56%**	→	→	→	→	**0.7%**
EU 15 attained	**0.43%**	**0.39%**								
Austria target	0.33%	→	→	→	0.51%	→	→	→	→	0.7%
Austria attained	0.47%	0.49%								
Belgium target	0.45%	0.55%	0.60%	0.65%	0.7%	→	→	→	→	→
Belgium attained	0.50%	0.43%								
Denmark target	0.81%	→	→	→	→	→	→	→	→	→
Denmark attained	0.80%	0.81%								
Finland target	0.33%	0.44%	→	→	0.51	→	~~0.7%~~	→	→	0.7%
Finland attained	0.40%	0.40%								
France target	0.33%	0.5%	~~0.5 – 0.7~~	~~0.5 – 0.7~~	~~0.5 – 0.7:~~	~~0.5 – 0.7~~	~~0.7%~~	→	→	0.7%
France attained	0.47%	039%	→	→	0.51%	→	→			
Germany target	0.33%	→	→	→	0.51%	→	→	→	→	0.7%
Germany attained	0.36%	0.37%								
Greece target	0.33%	0.33%	→	→	→	→	0.51%	→	→	0.7%
Greece attained	0.17%	0.16%								
Ireland target	0.33%	0.5%	→	→	0.6%	→	0.7%	→	→	→
Ireland attained	0.54%	0.54%								
Italy target	0.33%	→	0.33%	→	0.51%	→	→	→	→	0.7%
Italy attained	0.20%	0.19%								
Luxembourg target	0.88%	→	→	1.0%	→	→	→	→	→	→
Luxembourg attained	0.89%	090%								
Netherlands target	0.8%	→	→	→	→	→	→	→	→	→
Netherlands attained	0.81%	0.81%								
Portugal target	0.33%	0.33%	→	→	0.51%	→	→	→	→	0.7%
Portugal attained	0.21%	0.19%								
Spain target	0.33%	0.42%	0.5%	→	0.51%	→	0.7%	→	→	→
Spain attained	0.32%	0.41%								
Sweden target	1.0%	→	→	→	→	→	→	→	→	→
Sweden attained	1.02%	0.93%								
UK target	0.42%	0.46%	→	→	0.56%	→	→	0.7%	→	→
UK attained	0.51%	0.36%								
EU 12	-	-	-	-	**0.17%**	→	→	→	→	**0.33%**

Agreed individual EU commitments, complemented by Member States' latest information about national ODA goals

3.4. Uncertainty about future aid flows remains a major challenge

Scaling up aid is essential for the end of poverty, but it has to go along with substantial changes in the way donors operate. As aid flows become larger, **improving aid predictability and limiting its volatility** becomes eminently important, particularly for those spending programmes – including capital spending – that entail long-term recurrent cost commitments, such as teachers' and nurses' wages, and that are necessary to achieve the MDGs and for which significant financing gaps have been identified. Most Member States (14) have identified "aid predictability" as a core challenge to be discussed at the Doha conference.

3.4.1. The challenges for the donor community

European aid can be managed to avoid unnecessary volatility that places an added burden on partner countries. Doing more, better and faster, requires **the entire**

available tool-set to be consistently applied so as to enhance aid effectiveness and - as and where necessary – the **adaptation of budget cycles**:

- establishing **national timetables** to ensure gradually rising aid levels year-on-year in the run-up to meeting 2010 and 2015 targets;

- **joint multi-annual strategic planning** (joint country strategies and programming documents) as a basis for **multi-annual financial commitments;**

- improved capacities to **forecast aid disbursements to individual developing countries in the medium-term.** This includes **full participation in the OECD/ DAC "scaling up for results"-process**;

- **more predictable aid mechanisms,** that are better aligned with partner country's national development plans, e.g. budget support, namely the "MDG contract". Six countries (Finland, Ireland, Italy, the Netherlands, Sweden and the United Kingdom) indicated that they intend to favour increases in programme aid. However, despite the recognition that aid predictability is one of the most important issues facing development, an overwhelming majority of Member States underscored that they will continue to operate mainly in classical "project mode" in the future. In 2007 only one country, the Netherlands, spent more on programme aid than on project aid;

- **speedy application of the EU Code of Conduct on Division of Labour in Development Policy** in an increasing number of developing countries to reduce overlap by donors across and within countries, aid sectors, and aid instruments[5].

3.4.2. The challenges for developing partner countries

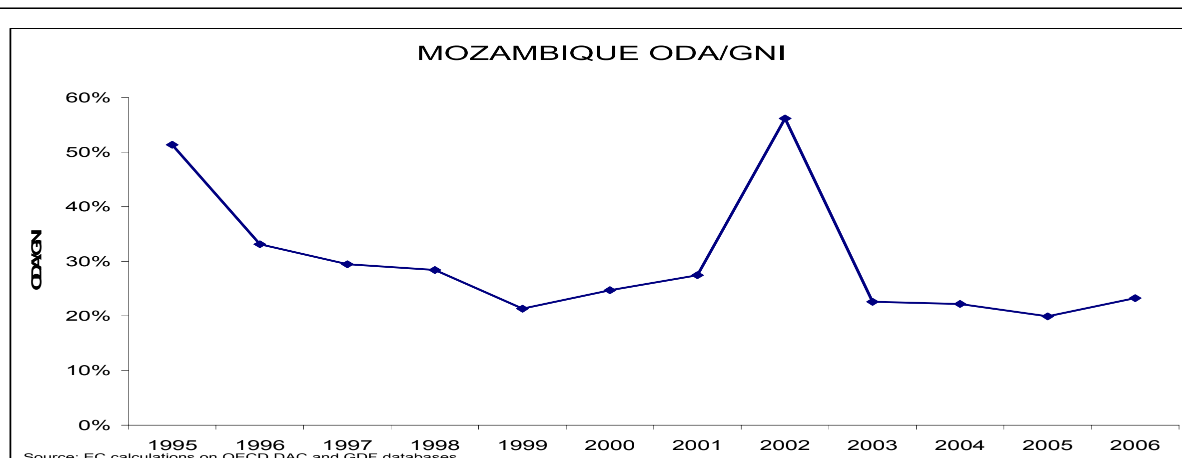
Developing partner countries that depend on scaled-up aid to attain the MDG have to manage the down-side of aid pledges, i.e. to cope with the unpredictability and volatility of aid flows.

Box 2: The real effects of aid unpredictability: the case of Mozambique

Aid predictability is at the centre of the debate on how to improve aid effectiveness. Aid predictability means that partners can be confident about the amount and timing of disbursements, whereas aid volatility refers to year-on-year increases and decreases in aid. Volatile and unpredictable disbursements hamper the attainment of the Millennium Development Goals and other development objectives of the partner's government, as budgetary allocations are rendered obsolete. If countries cannot make the necessary budgetary adjustments, lack of predictability can instead lead to macroeconomic instability.

Aid is more volatile than fiscal revenues and volatility increases with aid dependency; commitments consistently exceed disbursements, and disbursements cannot be predicted reliably on the basis of commitments alone. The main reason for aid unpredictability in budget support by the European Commission and bilateral donors is administrative and political obstacles on the donor side, followed by unmet conditionality in partners.

[5] More detailed information on these three initiatives can be found in the accompanying document SEC(2008) 435 "An EU Aid Effectiveness Roadmap to Accra and beyond - From rhetoric to action, hastening the pace of reforms".



Mozambique, generally lauded for achieving peace after 17 years of civil war, has received large amounts of aid and is highly dependent on it; most of the budget is financed through external sources and ODA/GNI has reached peaks and troughs ranging from 56% to 21% over the past ten years. Although Mozambique is an "aid darling", volatility of EU aid has been 55% (compared to 40% for foreign direct investment) since 2000, partly due to a huge aid surge in 2002 when donors responded to floods. Aid volatility is even more marked at sectoral level, so the aggregate national figures actually disguise even higher volatility of disbursements. Donor flows are unpredictable, because disbursements usually do not match aid commitments, with an average annual difference in EU aid of €111 million since 2000. The Government of Mozambique had to make adjustments in the face of aid volatility and unpredictability. In times of aid inflow shortages the cost of government borrowing increased and crowding-out of other domestic borrowing occurred. At the same time domestically-financed investment spending decreased. The case of Mozambique also shows that negative effects of aid shortfalls are reinforced by tax revenue shortfalls and current expenditure overruns, possibly because aid flows are pro-cyclical. Periods of excess aid are not used to accelerate investment spending to "catch up" with short falls; this implies that aid volatility has a permanent cost in terms of lost output in Mozambique, posing an even greater challenge to the government to reach the MDGs by 2015.

Mozambique and donors have made progress in improving aid predictability, have already signed a well-structured Memorandum of Understanding for budget support and have created a shared online data base that includes all donor payments and forecast payments almost in real time in a transparent manner.

Table: EU commitments and disbursements in Mozambique (in € million)

	2000	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***	***volatility***
Commitments	*441*	*579*	*1438*	*371*	*389*	*410*	*466*	*55%*
Disbursements	*683*	*513*	*1592*	*340*	*305*	*519*	*555*	*58%*
Difference	*241*	*-66*	*154*	*-32*	*-84*	*109*	*89*	

*Source: EC calculations on OECD DAC data; *volatility measured as standard deviation/mean.*
Sources:
Bulir, A. & Hamann, A.J. (2005). "Volatility of Development Aid: From the Frying Pan to the Fire?".
Celasun, O. & Walliser, J. (2005). "Predictability of Budget Aid: Experiences in Eight African Countries".

This calls for economic policies to control inflation, currency appreciation, sustainability of internal and external debt and excess liquidity. Prioritising spending in areas that increase potential growth, notably in human capital (education, health), science and technology capacity building and infrastructure, will help to increase the absorption capacity and to reduce the risks of "Dutch disease" effects (see box 3 below). Capacity-building in monetary policy, public finance and debt management

are essential complementary approaches that should include the development of the financial sector as it impacts on the effectiveness of monetary policy measures and the adjustment capacity of the economy.

Box 3: "Dutch Disease" –
the case of Ethiopia, Ghana, Mozambique, Tanzania and Uganda

Substantial aid inflows in foreign currency can have adverse effects on a country's external competitiveness through the appreciation of the real exchange rate and contraction of the export sector through increased demand for domestic services ("Dutch disease"). The same principle applies to other capital flows, such as remittances or income generated from the sale of natural resources.

Whether or not Dutch Disease occurs depends critically on the fiscal, monetary, and exchange rate policy response to aid inflows in partner countries, which determines whether or not foreign currency inflows are "absorbed" "not absorbed", "spent", or "not spent". Depending on the exchange rate regime, absorption is controlled by the exchange rate and interest rate policies of the Central Bank, which can decide whether to make foreign exchange available for importers (absorb) or to add the ODA to reserves (not absorb) Spending is dependent on fiscal policy, and the government spends ODA if the ODA is used to finance increased expenditure or to reduce taxation

The combination of these four policy choices lead to different macroeconomic outcomes. The IMF has done in-depth case studies on Ethiopia, Ghana, Mozambique, Tanzania, and Uganda, finding that the countries put in place macro-economic policies to avoid the unwanted Dutch disease effect. In the case of Ethiopia and Ghana, aid was channelled into reserves and not spent. With a view to coping with highly volatile aid flows, central bank policies may sensibly be geared towards absorbing less than available funds by increasing the country's foreign currency reserves at times of high inflows. Foreign reserves:

- *provide a buffer to maintaining macro-economic stability when aid volumes suddenly drop or when aid arrives later than pledged;*
- *facilitate currency convertibility and capital movements which can provide considerable economic benefits;*
- *finance current account deficits and defend the exchange rate when inflows decrease.*

The downside effect of this precautionary approach is that neither does the domestic economy fully benefit from aid inflows nor is the money used directly for poverty reduction measures. Donors may pressure partners to increase spending in response to an aid inflow, which can lead to inflation if it is not also absorbed.

This is what occurred in Mozambique, Tanzania and Uganda, where aid was spent but not absorbed, which is tantamount to an increase in government spending that is financed by printing money. These countries also avoided absorption with the objective to avoid Dutch Disease. In Uganda and (initially) Tanzania, Treasury bill sales were used to "mop up" excess liquidity to contain inflationary pressure leading to a rise in interest rates and the domestic debt burden.

Increasing foreign reserves and exercising fiscal restraint may not always be an appropriate policy option, especially considering current global macroeconomic imbalances. More desirable policy options for partners include absorbing aid flows and ensuring the quality of public expenditure by giving priority to spending in areas that increase productivity and potential growth, notably in infrastructure and human capital, which will offset the initial loss of competitiveness caused by Dutch Disease. On the donor side, spreading out aid flows to cover the donor orphans as well as donor darlings will limit the negative impact of aid surges on partners.

Source: IMF(2005) "The Macroeconomic of Managing Increased Aid Inflows: Experiences of Low-Income Countries and Policy Implications"; Washington DC

4. IMPLEMENTING INNOVATIVE SOURCES OF FINANCING FOR NEW CHALLENGES, NAMELY FOR CLIMATE CHANGE

4.1. Mobilisation of innovative finance for climate change mitigation and adaptation - an urgent challenge

Most of the existing initiatives to implement innovative sources of financing, such as the airline ticket tax, the International Drug Purchasing Facility (UNITAID), the International Finance Facility (IFF) and the Advance Market Commitments (AMC), were launched with a view to provide a stable, predictable and, in the case of the IFF, accelerated funding for the achievement of the Millennium Development Goals.

Meeting the MDGs poses an enormous challenge and climate change will make the task even more difficult. Climate change threatens to undermine the achievement of the MDGs and thus needs to be systematically integrated into development policy-making and planning at all levels. In addition, the mobilisation of innovative financing will be crucial.

While many studies have been conducted with a view to establishing the cost of future climate change adaptation and mitigations efforts, it remains difficult to exactly quantify costs. The UNFCCC Secretariat has estimated that the additional annual investment and financial flows needed for mitigation in 2030 may total US$200-210 billion and for adaptation, the annual financial flows needed in 2030 are US$49-179 billion - of which a large proportion will be required in developing countries.

It will be crucial to focus on the role of private-sector investments as they constitute the largest share of investment and financial flows (86% according to the UNFCCC). But even with private investments constituting the largest share, the amounts of public investment required are much more substantial than currently available funds from public sources. It is necessary to attract additional funding from other sources by creating innovative financing approaches. It is also important to ensure that public funds trigger the mobilisation of significant amounts of private sources.

Current ODA levels and pledged resources will not be sufficient to help developing countries deal adequately with climate change, in both its mitigation and adaptation dimensions. The Bali Climate Conference of December 2007 recognised that mitigation efforts in developing countries will necessitate appropriate technology development and transfer and will thus require adequate resources and enhanced cooperation. The Conference also called for increased action on adaptation, to enable climate-resilient development and to reduce vulnerability in developing countries, especially in the poorest countries and the Small Island Developing States.

The EU is leading efforts to address the strong links between climate change, poverty reduction and the achievement of the MDGs. As a concrete proof of Europe’s commitment to transfer clean technologies to developing countries, the Commission has launched the Global Energy Efficiency and Renewable Energy Fund (GEEREF). The GEEREF is an innovative global risk capital fund that will use limited public money to mobilise private investment in small-scale energy efficiency and renewable energy projects in developing countries and economies in transition.

To reinforce the EU leadership, the Commission took the initiative to launch a Global Climate Change Alliance (GCCA) between the EU and poor developing countries most vulnerable to climate change, in particular the Least Developed Countries (LDCs) and the Small Island Developing States[6].

Moreover, in December 2007, Commissioner Michel proposed looking into the **feasibility of an innovative Global Climate Financing Mechanism** (GCFM), modelled on the IFF structure, **considering** that **delaying action on climate change would greatly increase the future costs.** This militates in favour of frontloading assistance. One of the key issues for such a Global Climate Financing Mechanism will be to secure the reimbursement of the funds that will be raised on the capital markets and that will be disbursed as grants to the poorest and most climate-vulnerable developing countries. One option is a mechanism similar to the IFF for Immunisation (IFFIm), which relies chiefly on long-term budget commitments from supporting countries, based on ODA. The added-value of the mechanism is the **frontloading of disbursements.** Other approaches that would also ensure **additionality to current ODA** need to be explored: Such innovative financing could be linked to the carbon market, like a share of the revenue generated by the auctioning of emission rights in the EU's future Emissions Trading Scheme (ETS). Airline ticket levies, which have been used by France to back the IFFIm and to finance the International Drug Purchase Facility (UNITAID), could also be considered.

The Commission's package of January 23, 2008 on "Climate action and renewable energy package" includes the proposal to generate predictable finance through auctioning of emission trading allowances. The auctioning process will generate significant revenues for Member States, which will help adjusting towards a low carbon economy, supporting research and development and innovation in areas like the capturing and storage of 'renewables' and carbon, helping developing countries and emerging economies to adapt to climate change and to invest in energy efficiency.

Other proposals, such as the **Clean Technology Fund**, launched by the UK, the US and Japan, are geared towards direct funding from the national budgets.

4.2. A small number of EU Member States is promoting innovative sources and instruments

A number of potential financing tools might be used for climate change or other Global Public Goods, without being necessarily linked to a frontloading mechanism.

During 2007 three EU countries (Cyprus, France, the UK) mobilised funds through innovative mechanisms and five contributed to innovative instruments while nine Member States are in the process of assessing or introducing new mechanisms. However, most EU countries are not considering participation in any of the existing innovative sources and instruments.

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[6] Communication from the Commission of 18 September 2007: Building a Global Climate Change Alliance between the European Union and poor developing countries most vulnerable to climate change. Council Conclusions of 20 November 2007 on a Global Climate Change Alliance between the European Union and poor developing countries most vulnerable to climate change.

- **Air ticket contributions**: France and the UK have an air ticket **tax** but, unlike France, the UK did not earmark any proceeds for development finance. Luxembourg will collect **voluntary contributions from aid passengers** as of April 2008. Cyprus has also introduced an air ticket tax, but has yet to sort out legal constraints relating to the contract with the private airport operator. In 2007, Portugal's Parliament recommended studying the introduction of an airline ticket tax.

- Cyprus (€800,000) and France (€164 million) paid their proceeds from the air ticket tax to the **International Drug Purchase Facility (UNITAID)** and the UK contributed £13.7 million (€19 million) through regular ODA.

- **International Financing Facility for Immunisation (IFFIm)**: The disbursements of the UK (£9,043,200 = €12.6million), France (€19.2 million), Italy (€5.76 million), Spain (€9.1 million) and Sweden (€1.9 million) under their existing long term commitments served the backing of the IFFIm, following the first bond issue of US$ 1 billion in 2006.

- In February 2007, the UK and Italy (together with Canada, Norway, Russia and the Bill & Melinda Gates Foundation) launched the first **Advance Market Commitment (AMC) for the pneumococcal disease**, under which the first disbursements are expected in 2008. Spain has expressed interest in a further **AMC for malaria**.

- **Financial and currency transaction levy**: Belgium and France had earlier introduced legislation to tax such transactions; its effective implementation is linked to the existence of a similar levy in the other EU Member States. Austria and Italy expressed interest in introducting a tax on financial or currency transactions at the EU level.

- **Climate change** gives a new boost to work on innovative financing and appears to inspire some Member States that have so far been reluctant to take a fresh look on innovative finance:

– Germany has announced a new initiative on auctioning its CO_2 emission allowances that is expected to raise €400 million annually, a large share of which will be made available for climate-related funding in developing countries.

– The UK underscored the need for the EU to promote innovative sources of financing for climate change, for a decision at the Conference of Parties in Copenhagen in December 2009.

- The **Leading Group on solidarity levies** initiated by France in 2006 with a view to presenting a platform of proposals for the Doha Conference is also discussing the contribution of carbon trade revenues to climate change adaptation and mitigation. Austria, Belgium, Cyprus, Germany, Luxembourg and the UK participate in this forum, and Finland and Italy joined in 2007, demonstrating their renewed interest in the debate on innovative sources of financing.

4.3. Policy recommendations

- **Additionality**: Innovative sources of financing should be effectively in addition to the Member States' ODA commitments and must not distract attention and finance from achieving the MDGs and other internationally agreed development objectives. Existing resources for development should take into account climate change considerations.

- **Effectiveness:** The implementation in recipient countries of actions supported by innovative sources of finance has to respect the aid effectiveness principles, in terms of ownership, alignment, harmonisation and accountability. It is therefore crucial to avoid a multiplication of parallel implementing structures. Innovative finance must rely, as much as possible, on existing development institutions and financing instruments, including, where applicable, budget support.

- **Transaction and financial costs** possibly entailed by these instruments require special attention: A cost-effective approach is therefore needed to assess their real added value in terms of stability, predictability and scaling-up of development finance.

5. NEW CHALLENGES TO DEBT SUSTAINABILITY IN DEVELOPING COUNTRIES

The EU commitments on financing for development were reviewed in 2005, prior to the launch, by the G8, of the Multilateral Debt Relief Initiative and the UN Summit. At that time the debt-related revised commitment focussed on support for a mechanism to alleviate multilateral debt. As a result the reference text regarding debt as part of the revised EU 2005 commitments is partially outdated.

5.1. The implementation of the HIPC initiative and the challenge of preserving debt sustainability

Member States, in their replies to the 2008 Monterrey survey, generally shared the view that **debt sustainability is crucial for achieving the MDGs** and that good progress was made in recent years to restore debt sustainability in low income countries (LICs). However, **challenges remain**, mostly related to:

- The **implementation of the HIPC initiative:** The initiative is not yet entirely funded and faces a low participation by commercial and some non-Paris Club official creditors. Moreover, there are challenges for the remaining eligible countries to access the initiative, ranging from political instability to difficulties in clearing protracted multilateral arrears.

- Cases of **aggressive litigation by commercial creditors and distressed-debt funds**.

- The **emergence of new sources of financing in the form of lending at non-concessional rates** by non Paris-Club official and commercial creditors and the increasing access of low-income countries to international capital markets.

Continued participation of creditors and donors in the existing debt relief initiatives, namely the Heavily Indebted Poor Countries initiative (HIPC) and Multilateral Debt Relief Initiative **(MDRI) remains crucial** – while adhering to the principle of additionality as stipulated in the Monterrey Consensus. Whereas the IMF and World Bank had reported that some Member States were experiencing delays in delivering HIPC debt relief[7], those EU countries, in response to the Monterrey survey 2008, emphasised that the situation has since evolved positively.

A related problem has to do with the **high cost of clearing protracted arrears to multilateral organisations of countries eligible for the HIPC initiative**. The cost of arrears-clearance can represent a significant burden for creditors and donors alike. While some action is being taken in this regard in the relevant institutions (IMF, World Bank; African Development Bank), some ACP countries face a similar situation for loans provided under earlier European Development Funds. EU Member States seem positive to find some solution for this problem.

Maintaining long-term debt sustainability in low-income countries after the implementation of the HIPC/ MDRI initiatives is an important challenge. Recent cases of aggressive litigation by commercial creditors that buy HIPCs' debt in secondary markets at a discount to obtain profits via litigation have diluted some of the benefits from debt relief. The high vulnerability of those countries to potential external shocks and re-accumulation of unsustainable debt due to negligent borrowing and lending that disregards debt sustainability implications can lead to new cases of debt distress. Some **non Paris-Club official and commercial creditors are lending at conditions, which are neither always fully transparent nor in line with concessionality requirements as defined by the IMF/WB Debt Sustainability Framework**. Furthermore, due to the good macro-economic performance in recent years an the lower debt burden, some LICs now have improving sovereign credit ratings and are able to directly access international capital markets for sovereign borrowing. While this is a very positive development - also with a view to developing the local financial sector - it may entail significant risks for debt sustainability, particularly in countries with debt-management capacity constraints.

The Monterrey survey revealed that **Member States strongly support measures to ensure more responsible lending** among non-Paris Club and commercial creditors to avoid free-riding and aggressive litigation against developing countries. Member States support the use of the **IMF/ WB Debt Sustainability Framework** to guide lenders and borrowers' decisions on LICs' new external borrowing. Recently there have been further initiatives to deal with these challenges, e.g. in January 2008 the **OECD Working Party on Export Credits and Credit Guarantees** adopted a set of principles and guidelines to promote sustainable lending practices in the provision of official export credits to LICs: The OECD countries commit to respecting concessionality requirements, ensuring project sustainability and providing relevant information.

[7] Enhanced Heavily Indebted Poor Countries (HIPC) Initiative–Status of Non–Paris Club Official Bilateral Creditor Participation (September 10, 2007).

However, not all EU Member States are OECD or Paris Club members; this implies that they are not yet bound by those initiatives.

5.2. Policy recommendations

In the light of the trends and challenges described above, the Commission recommends the following measures to be taken by the EU:

- All EU Member States should **continue** to timely and fully **support** the implementation of the **HIPC/MDRI** to ensure that eligible countries do receive the pledged debt relief. Regarding **protracted arrears towards multilateral organisations** the European Investment Bank (EIB) should be asked to propose mechanisms to deal with the arrears owed to it. Concerning EDF loans, the Commission and the Council need to **explore ways of minimising the cost of EDF arrears-clearance in the context of the HIPC initiative**.

- To ensure **long-term debt sustainability** the EU should act against free-riding behaviour and prevent litigation by aggressive debt distressed funds[8]. Member States should apply the IMF/ WB Debt Sustainability Framework in their own lending and aid policies, and apply existing principles and guidelines like those of the OECD regarding sustainable lending when providing official export credits.

- All Member States should **apply the Paris Club commitment not to sell claims on HIPCs to creditors that are unwilling to provide debt relief**. All stakeholders should **enhance transparency in the process of debt contraction by improving data and information sharing** in order to help countries that have benefited from the HIPC initiative and the MDRI to maintain long-term debt sustainability.

- In other fora, including at the forthcoming Doha Conference on Financing for Development to Review the Implementation of the Monterrey consensus and its preparatory process, EU Member States can **take co-ordinated action** to help restore and preserve debt sustainability by **supporting**:

– **Dialogue with** other – multilateral, bilateral or commercial – **creditors and** with **borrowing countries**;

– **Technical assistance** (i) to strengthen debt management capacities of low-income countries and (ii) to assist efficient negotiations with non-Paris Club official bilateral creditors and commercial creditors with a view to preventing litigation by distressed-debt funds and supporting long-term sustainable borrowing strategies;

– **Commercial debt buy-backs**, especially for HIPCs, e.g. through the IDA Debt Reduction Facility.

[8] The IDA/ IMF report "HIPC initiative and MDRI – status of implementation" of August 27, 2008 reports on the litigation case Donegal versus Zambia", p. 34, Box 5.

6. GLOBAL PUBLIC GOODS (GPGS)

In 2008 Monterrey survey Member States were keen to increase the supply of global public goods, and there was agreement on the priority GPGs identified by the International Task Force, i.e. those related to health and the environment, but Member States were not enthusiastic about the recommendations of the International Task Force. As a consequence of the Member States' position, and on the basis of its own analysis, the Commission did not propose an EU action plan as envisaged in 2005 when the EU adopted its renewed "Monterrey commitments". In May 2007, the Council called on the Member States and the Commission to strengthen their action on global public goods through enhanced collaboration and alliance-building with developing countries[9].

As the EU has undertaken to support global initiatives and funds, while fully respecting its commitments with regard to aid effectiveness, the Monterrey survey 2008 focussed on the financing mechanisms for global public goods, in particular global funds and partnerships. The objective to provide aid more effectively may lead to criteria being drawn up for EU participation in global funds[10]. Global funds and partnerships are an opportunity for the EU to strengthen its collaboration and alliance-building with developing countries for the provision of GPGs.

The EU focus on Global Public Goods remains significant; attention seems now to be moving towards the delivery and financing mechanisms that can be used to increase the supply of such goods.

6.1. EU trends for investing in global funds and partnerships

6.1.1. Using allocative criteria to invest in Global Funds and Partnerships

Most Member States use some form of principles and criteria when taking decisions about investing in global funds and criteria. These principles are frequently drawn from national development policies and overall strategies, take account of budget constraints, and are often in support of the Millennium Development Goals. The criteria broadly, rather than narrowly and precisely, guide Member States in their decisions. It seems as though Member States tend to adopt a relatively flexible approach to such investment judgements, although always respecting their national overall policies and strategies.

There was general support from Member States for the use of common EU criteria. However, this interest was qualified by a frequently stated concern that such criteria should act as a guide for good practice, but not be imposed and binding on Member States. A minority of Member States felt that the EU was not the most appropriate forum, or that such an approach would be unlikely to add much value to the decisions that each Member States would take. The Commission has looked at a list of criteria that could be used.

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[9] Council Conclusions "Keeping Europe's promises on Financing for Development" 9556/07 of 15 May 2007.

[10] See para 107 & 108 of the European Consensus on Development.

6.1.2. Investment trends

Overall the replies to the Monterrey survey showed that Member States are not able to give a clear picture of their investment plans up to 2010. Whilst many were able to provide information about investments planned in 2008, information was not comprehensively presented for the following two years. Accordingly, it is difficult to draw conclusions on the likely up- or down-scaling of EU investments in such funds. Member States, that have historically invested large amounts, indicated that this would continue or increase.

The public goods attracting most interest of Member States for investments are health, the environment and education, with nominal, scattered interest in energy, gender issues, and research.

6.1.3. Supporting a country-led approach

Those Member States that answered this question were concerned to ensure that global funds and partnerships support a country-led approach to development in line with the Paris Declaration commitments on ownership, alignment and harmonisation, and several Member States provided examples of their efforts in this regard. Yet the lack of responses from a significant number of EU countries indicates that there may be scope to enhance the attention being paid to this issue. The EU needs to continue its efforts for effective delivery in support of country-led strategies. The emphasis should not be placed on creating new multilateral instruments or global funds, but rather focusing on reinforcing coordination amongst donors through joint analysis, response and monitoring.

6.2. European co-ordination mechanism for contributions to Global Funds and Partnerships

Most of the Member States that expressed their view on the issue in response to the Monterrey survey were in favour of some form of co-ordination and considered that it could improve European coordination and coherence, reduce financing overlaps, and improve the visibility of EU contributions to global funds and partnerships, all of which should lead to increased impact in poverty reduction. The Commission supports the idea of a light but effective coordination mechanism. While several Member States did not express any preference, those that are not in favour of creating an EU co-ordination mechanism did not explain their response or stated that they did not see any potential benefits from new mechanisms.

6.3. Recommendations

There is sufficient interest to develop a more common approach to and understanding of global funds and programmes in support of the provision of global public goods.

- During 2008, the Commission, in close collaboration with Member States, will draw up common principles for EU investment in global funds and partnerships.

- In order to enhance coordination, harmonisation and alignment, the European Union should create a common knowledge platform on Commission and Member States' activities with global funds and partnerships. This would facilitate greater

sharing of experience, financing plans, and policy analysis, which would, in turn, raise the Union's visibility in such activities and lead to greater impact for poor people. Coordination between Commission and Member States in relation to funds is especially important at the time of replenishment.

7. COMPENSATORY FINANCE SCHEMES: A NECESSARY INSTRUMENT OF DEVELOPMENT POLICY TO DEAL WITH EXOGENOUS SHOCKS

7.1. Disaster Preparedness

Disasters undermine the results of development investments in no time and remain a major impediment to developing countries' efforts to achieve sustainable development and poverty eradication. The number and frequency of disasters is rapidly growing, in particular weather-related disasters, as a result of increasing climate change. The European Consensus commits the EU to support disaster prevention and preparedness in disaster-prone countries and regions with a view to increasing their resilience in the face of these challenges. Evidence has long suggested that **disaster risk reduction (DRR) has a high cost/benefit ratio**, i.e. **preparedness, prevention and mitigation pay off.**

Most (17) Member States and the Commission fund DRR efforts in developing countries on a regular basis from development or humanitarian aid budgets, or both.

In response to the question in the Monterrey survey regarding planned measures to increase the investment in DRR efforts in developing countries, ten Member States and the Commission indicated that they are in the process of stepping up support for DRR in various ways, e.g. through policy and institutional approaches, including a distinct DRR and development policy, inter-ministerial cooperation, working papers and guidelines (three Member States and the Commission). Four EU countries and the Commission are enhancing bilateral support for DRR at country and regional level, by ways of both projects/programmes and improved mainstreaming. At multilateral level, four Member States support the UN **International Strategy for Disaster Reduction (ISDR)** system to implement the Hyogo Framework for Action. Four Member States also fund the World Bank's Global Facility for Disaster Risk Reduction (GFDRR) and a single EU country supports the UNDP Bureau for Crisis Prevention and Recovery (BCPR). The GFDRR and the BCPR help partner countries to build disaster risk reduction capacity at national level. The United Kingdom (10%) and Luxembourg (5%) have committed to devote a certain percentage of their budgets to disaster risk reduction.

The Commission provides different funding to promote disaster preparedness:

- €12 million for the first phase of the **ACP-EU Natural Disaster Facility** for regional capacity building in disaster risk reduction in the six ACP regions. Principles have been drawn up for EU investment in global funds and partnerships, and additional funds for a phase two have been earmarked.

- €100 million is earmarked for increased **Drought Preparedness and Dipecho programmes** and the **Global Climate Change Alliance.**

- €25 million is being used for the **Global Index Insurance Facility** (GIIF), a multi-donor trust fund at the World Bank Group. The GIIF will become operational in 2008 and aims to reduce the vulnerability of ACP populations to external shocks/ natural disasters by expanding the use of index insurance as a risk management tool.

In the follow-up to the European Consensus on Development and on Humanitarian Aid and in order to build an EU strategic approach in line with the Hyogo Framework for Action, the Commission intends to develop, in 2008, a proposal for an EU Strategy for Disaster Risk Reduction in Developing Countries. In this context the Commission will hold a stake-holder consultation and will engage in further consultations with interested Member States. Concerning priority areas that this strategy should address EU countries gave a wide-range of recommendations in their response to the Monterrey survey, they emphasised:

- the need to focus on capacity building and institutional strengthening (nine replies);

- preparedness, including early warning as a priority area, at all relevant levels and in specific sectors (infrastructure was mentioned repeatedly) (six replies);

- awareness raising, education and advocacy (four replies).

- Other views highlight support for the UN ISDR system; a stronger prevention focus; risk analysis and monitoring systems urban areas. Further recommendations had to do with guiding principles and approaches, such as the need to address links with climate change, to mainstream disaster risk reduction into development and humanitarian aid and to intensify donor coordination. There was also a call to intervene at local and community levels, to take into account gender issues and to bridge the gap between humanitarian assistance and development cooperation, as well as to focus on particularly vulnerable regions such as Sub-Saharan Africa, Central America, South America (Andean Region), and South-East Asia.

7.2. Compensatory finance

In the discussions about *ex-post* approaches to mitigate the negative effects of exogenous shocks, compensatory finance has always taken a prominent position. The EC's Stabex and Sysmin instruments, applied earlier, and the current FLEX mechanism for ACP countries, introduced under the 9th European Development Fund (EDF), are among the best known examples of compensatory finance schemes in the EU. Stabex provided for financial assistance in the event of loss of export income generated by specific agricultural commodities, Sysmin did the same for mining export income. By replacing the Stabex and Sysmin instruments by FLEX, the EC shifted from (sub)sector-specific compensation schemes towards a macro-economic and budgetary approach. Its prime goal is to "*safeguard socio-economic reforms and policies that could be affected negatively as a result of a drop in revenue…*"[11].

[11] Cotonou Agreement, Article 68.2.

Current discussions around compensatory finance have questioned the desirability of continuing such donor-funded schemes when market-based arrangements could be used and also led to suggestions for making the schemes more effective and predictable. Against this background the Monterrey questionnaire asked for Member States' views on the appropriateness of compensatory finance schemes and, if deemed relevant in the present-day context, on the most important characteristics that such a scheme should have.

Most EU Member States (17) and the Commission are in favour of keeping an *ex post* compensatory finance scheme for developing countries as part of development cooperation instruments. Three EU countries signalled opposition against such an instrument, while eight Member States had no opinion yet.

Concerning the most desirable characteristics of compensatory financed schemes, those Member States that replied to the question hold a variety of views, with special reference to the level of loss that should be compensated, as well as on implementation arrangements. Nevertheless, the following conclusions can be drawn from the survey:

- In terms of the impact of the exogenous shock that would need to be compensated, there is a preference to focus on **a drop in domestic production** (e.g. as measured in terms of GDP, although the current account could also be looked at). Fewer Member States favour a focus on the drop in export earnings or in government income.

- The focus should be on the **effects of both price and weather shocks**, i.e. looking at a broad range of external causes.

- The current state of affairs in FLEX whereby governments submit their own data on effects of external shocks was not the method preferred by Member States. The vast majority of Member States indicated a preference for such data to be validated by international organisations, while many Member States would like to base the measurement on external, publicly accessible, verifiable statistics (e.g. commodity exchanges for price shocks; satellite data for weather-related shocks).

- The survey also showed that Member States rather support the use of country-wide indicators than a return to a (sub)sector-based approach (such as Stabex, Sysmin).

- Eligible countries should be Least Developed Countries, commodity-dependent countries or a combination of the two.

The Commission underlines that the eligibility to any compensatory finance scheme should be linked to the level of development. In determining levels of support the degree of poverty should be taken into account. It will also be crucial to assist countries that are not yet eligible to budget support in reaching the MDGs in the face of an exogenous shock, and build up in-country capacity to receive budget support and participate in market based risk management instruments in the future. Furthermore, the feasibility of providing 'emergency budget support' in exceptional cases and under specific conditions could be investigated. The Commission also

suggests investigating whether the risk of having to pay out rather large sums in compensatory finance can be insured and at what cost.

Most Member States were hesitant about their interest in contributing to an improved Compensatory Finance Scheme at EU level. Ten Member States plus the Commission indicated they could possibly be interested, while others indicated the need for more information before considering this issue or did not reply to the question. Five Member States answered they had no interest in joining an EU scheme, partly because with the existence of a system such as FLEX they felt no need to add bilateral contributions. One Member State favoured working within the existing aid architecture for shocks (FLEX, IMF's Exogenous Shocks Facility), but took the view that the EU should consider whether it would be prepared to respond to requests to provide additional support in the event of increased weather-related shocks attributed to climate change. Such support could be delivered through existing mechanisms (such as FLEX) or market-based approaches, or a combination of the two.

7.3. Recommendations

Most Member States and the Commission consider that a compensatory finance scheme continues to be relevant in development cooperation and are interested in considering improvements to the existing (FLEX) system, also in view of the expected effects of climate change. The scope of the compensatory finance scheme should be country-wide, focusing on significant adverse effects of external shocks (both price- and weather-related; beyond the control of the country) on the economy of the country and operate for poor and/or commodity-dependent countries. The scheme should work on reliable indicators, but should also lead to quick disbursement.

On the basis of the above, it is **proposed** that the **EC conducts a feasibility study on an EU compensatory finance mechanism.** This feasibility study would:

- investigate to what extent the use of external data (price indices, satellite-based weather data) could lead to faster decision-making and disbursement;
- analyse the reliability of external data, the need for validation and the correlation with economic losses;
- assess the financing implications for covering an adequate proportion of the losses associated with external shocks in the least developed and commodity-dependent developing countries (assessing the ACP countries as well as wider geographical coverage);
- and assess the options and arrangements for covering the costs of such a compensatory finance scheme (including the option of providing relatively lower grants for richer countries, which could increase the scope of coverage).

The results of this study should be available in time for the next revision of the EC-ACP Partnership Agreement by February 2010. Meanwhile the Commission has

worked on a partial revision of the FLEX mechanism in order to meet some of the concerns raised in the consultation process[12], i.e. to move away from compensation for worsening budget deficit towards a more GDP-based approach and to accelerate the allocation of funds and disbursements to strengthen the counter-cyclical nature of the mechanism. The revision proposal does not alter the objective of the FLEX mechanism but tackles some implementation arrangements as described in Annex II of the EC-ACP Partnership Agreement. The revision requires a joint EC-ACP Council decision and is expected to be adopted in the first half of 2008 for immediate application to the year 2007.

8. REFORM OF THE INTERNATIONAL FINANCIAL INSTITUTIONS

8.1. Options for strengthening the voice and representation of developing and transition countries at the World Bank

There is broad recognition that changes are required to improve the representation of developing and transition countries, which are large borrowers from the WB Group but are currently underrepresented in terms of seats on the WB Board. The situation is particularly acute for **Sub-Saharan African countries** which have two seats for 46 countries, while other developing regions (Latin America, developing countries in Asia and North Africa/Middle East) each have three seats for fewer countries.

In view of the forthcoming discussions at the IMF/ World Bank Development Committee meeting in April 2008 and building on the World Bank's discussion paper for the previous meeting of October 2007 presenting options for strengthening the voice and representation of developing countries on the World Bank Board, the Monterrey survey 2008 explored Member States' views regarding the different proposals. All options found some support among the 25 EU countries that responded to the question, but with wide variations:

- A large majority of Member States (22) that together represent 25.92% of total votes in IDA would favour an increase of the basic vote.
- There is also strong support (14 Member States) for the option to open the posts of the World Bank President and IMF Managing Director to all countries.
- 11 EU countries would also consider a selective capital increase for developing countries.
- Increasing the Board size to create a third seat for African countries and introducing double majorities for strategic decisions are options that seven EU countries would also think about.

The Commission considers that capping the number of countries per constituency and establishing a third seat for African countries would be the best short-term option.

[12] Commission proposal COM(2007) 337 of 19.6.2007.

The commitment among Member States to provide support to constituency offices of developing countries on the World Bank Board is less developed: only eight are ready to provide bilateral technical assistance, and only two would provide bilateral financial support; another eight EU countries believe that developing country constituency offices do not need support, whereas 11 Member States would prefer such support to be financed from the EC budget or the EDF. The Commission supports the idea of supplying technical or financial assistance to large developing country constituencies, and would examine the possibility of financing this through the European Community budget or the EDF.

8.2. Overall very positive, but differentiated assessment of the EU coordination at the IMF, the World Bank and regional development banks

Over time the support for **strengthening the EU voice** and appreciation of closer EU coordination in the international financing institutions and – more recently - in regional development banks has markedly increased, albeit with variations regarding the different institutions:

- The overall functioning and quality of EU coordination at the World Bank Board received the best score (21 Member States); two countries believe that further improvements are necessary.
- According to the large majority of replies (17 Member States) EU coordination also functions well at the IMF, but seven Member States see scope for improvement.
- The assessment of the situation in **regional development banks** was more critical. While several Member States are not members of regional development banks and either did not respond or preferred to stay neutral in their assessment, the majority of those that expressed an opinion underscored the **need to improve EU coordination.**

Regarding future guidelines for the EU coordination:

- **More joint positions on long-term strategic issues** is something that is strongly supported by 17 Member States (out of 24 replies to the question) for the World Bank and 12 for the IMF.
- **More joint positions prior to annual/ spring meetings** are favoured by 12 Member States in the case of the World Bank and by seven regarding the IMF.
- Compared to opinions expressed in the context of the annual Monterrey reports in previous years there has been a **notable shift in favour of a single EU seat**, **although** this **remains**, **at present**, **a minority opinion** held by:
  - seven Member States in the case of the IMF (Austria, Cyprus, Finland, Greece, Italy, Luxembourg, Netherlands),
  - four Member States regarding the World Bank Board (Austria, Luxembourg, Netherlands, Slovak Republic),

– and only two Member States for the regional development banks (Austria and Luxembourg).

– The Commission would consider **a single euro-group seat in the IMF and a single EU seat in the World Bank as an ultimate goal.**

- In order to improve its supportive role in EU coordination for IMF/World Bank Board discussions the Commission would need better access to Board strategic documents. Gaining observer status at the World Bank Board would greatly facilitate that task; eight out of 22 Member States that replied to this section support the Commission's approach; five Member States are explicitly against.

8.3. The way forward

The Commission advocates

- constructive EU cooperation to select the most effective option for strengthening the voice and representation of developing countries on the Board of the World Bank;

- further improved EU coordination prior to the spring/annual meetings. In this context **more references** by Member States **to EU positions in the World Bank/IMF Development Committee** would also be an asset for fostering effective EU representation and visibility;

- **continuing the upwards trend in common statements by** the EU group on the World Bank Board**, in particular for long-term strategic issues;**

- substantially reinforcing EU coordination on the Boards of the regional development banks, based on the good practice in the IMF and World Bank.

Annex 1:
EU commitments on financing for development

1. ODA Volumes

ODA target 2006

"In pursuance of the undertaking to examine the means and timeframe that will allow each of the Member States to reach the UN goal of 0.7% ODA/GNI, those Member States that have not yet reached the 0.7% target commit themselves – as a first significant step – individually to increase their ODA volume in the next four years within their respective budget allocation processes, whilst the other Member States renew their efforts to remain at or above the target of 0.7% ODA, so that collectively an EU average of 0.39% is reached by 2006. In view of this goal, all the EU Member States will in any case strive to reach, within their respective budget allocation processes, at least 0.33% ODA/GNI by 2006."

(Council conclusions of 14.03.2002 on the UN Conference on Financing for Development (Monterrey)

"The Council encourages those Member States that have not reached the target for 2006 or are not on track to achieve the respective individual baseline set for 2010 to make all efforts to reach those targets."

(Council conclusions of 15.05.2007on Keeping Europe's Promises on Financing for Development)

ODA targets 2010/2015

"…the EU agrees to a new collective EU target of 0,56 % ODA/GNI by 2010, that would result in additional annual € 20bn ODA by that time.

- I. Member States, which have not yet reached a level of 0,51 % ODA/GNI, undertake to reach, within their respective budget allocation processes, that level by 2010, while those that are already above that level undertake to sustain their efforts;

- II. Member States, which have joined the EU after 2002, and that have not reached a level of 0,17 % ODA/GNI, will strive to increase their ODA to reach, within their respective budget allocation processes, that level by 2010, while those that are already above that level undertake to sustain their efforts;

- III. Member States undertake to achieve the 0.7% ODA/GNI target by 2015 whilst those which have achieved that target commit themselves to remain above that target; Member States which joined the EU after 2002 will strive to increase by 2015 their ODA/GNI to 0.33%."

(European Consensus on Development with reference to Council conclusions of 24.05.2005)

ODA - national timetables

"Underlining that this issue falls within the competence of Member States, the Council welcomes the Commission's proposal on national timetables and encourages Member States concerned to work on such national timetables, by the end of 2007, to increase aid levels within their respective budget allocation processes, towards achieving the established ODA targets."

(Council Conclusions of 15.05.2007)

ODA to Africa

“EU will increase its financial assistance for Sub-Saharan **Africa** and will provide collectively at least **50% of the agreed increase of ODA resources to the continent**, while fully respecting individual Member States priorities’ in development assistance.”

(European Consensus on Development with reference to Council conclusions of 24.05.2005)

2 Innovative Sources of Financing

“The Council will continue to consider the most promising options for innovative sources of financing for development, in order to increase the resources available in a sustainable and predictable way.”

(Council conclusions of 24.05.2005)

3 Debt

"The Council welcomes the participation of the EU Member States and the Community in the debt relief operations, including the HIPC and; if relevant, Multilateral Debt Relief Initiative (MDRI), and encourages continued participation while adhering to the principle of additionality as stipulated in the Monterrey Consensus."

(Council Conclusions, 15.05.2007)

“Debt reduction … provides predictable financing. The EU is committed to find solutions to unsustainable debt burdens, in particular the remaining multilateral debts of HIPCs (Heavily Indebted Poor Countries), and where necessary and appropriate, for countries affected by exogenous shocks and for post-conflict countries."

(European Consensus on Development)

4 Aid effectiveness

"…the EU stresses the need to improve in parallel the quality and effectiveness of ODA as well as better donor practices and the need to enhance the capacity and economic sustainability of increased ODA for our partner countries.

"…the EU will ensure the implementation of the concrete recommendations contained [in the report Advancing coordination, harmonisation and alignment' of November 2004], including a more effective framework for development assistance at EU level and division of labour and complementarity at country level in the context of joint, multi-annual programming based on the partner country's poverty reduction strategies.

The EU is fully committed to a timely implementation and monitoring of the Paris Declaration on Aid Effectiveness including setting monitorable targets for 2010 and of the EU specific commitments adopted at the Paris Forum."

(Council conclusions of 24.05.2005)

5 More predictable, less volatile aid mechanisms

The Council recalls the EU commitment to more predictable and less volatile aid mechanisms which are crucial for effective planning to progress on the MDGs and acknowledges that speedier progress is required for its implementation. Where circumstances permit, the use of general or sectoral budget support as one instrument among others should increase as a means to strengthen the ownership, support partners' national accountability and procedures to finance national poverty reduction strategies and to promote sound and transparent management of public finances."

(Council Conclusions of May 15, 2007)

In order to better respond to the need for stable resources and in view of the expected increases in ODA flows, the EU will develop new, more predictable and less volatile aid mechanisms. Such mechanisms could consist in the provision of a minimum level of budgetary aid secured in a medium term perspective and linked to policy performance in the partner countries, in particular in relation to the commitment towards achieving the MDGs in national poverty reduction strategies."

(Council conclusions of 24.05.2005)

6 Untying of aid

[The Council will address] the challenge of untying of aid by adopting as soon as possible on the basis of the Commission's proposal, a regulation on the access to EC external assistance; the EU will support ongoing debates at the international level on further untying of aid beyond existing OECD/ DAC recommendations."

Council Conclusions of 24.05.2005

"The Council calls on the Member States to support a further extension of the OECD/DAC Recommendations that focus on the access for developing countries and promote local preferences.

The Council calls upon the donors that have not yet untied their aid to make efforts in this direction and reiterates that the EU has agreed on further advancing, within the relevant international fora, untying of food aid and food aid transport.

The Council recalls the EU Directive on Government Procurement and underlines the importance of its implementation in this context."

Council Conclusions of 15.05.2007

7 Exogenous shocks

The Council urges Member States and the Commission to strike a new balance between ex-post natural disaster responses and ex-ante risk reduction strategies, with a stronger emphasis on the latter, within a coordinated approach to disaster prevention and preparedness and on which developing countries and donors need to intensify efforts to reduce vulnerability against exogenous shocks in line with the Hyogo Framework for Action. In that regard it welcomes the implementation of an exogenous shock facility within the IMF framework.

(Council Conclusions of 15.05.2007)

"Some developing countries are particularly vulnerable to natural disasters, climatic change, environmental degradation and external economic shocks. The Member States and the Community will support disaster prevention and preparedness in these countries, with a view to increasing their resilience in the face of these challenges."

(European Consensus on Development)

"In order to mitigate the impact of exogenous shocks, including price vulnerability, on developing countries economies, the EU will support the operationalisation of market based insurance schemes and explore possibilities for temporary suspension of debt servicing on a case by case basis. Further, the EU will strengthen and improve access to existing financing mechanisms such as those provided for in the Cotonou Agreement (FLEX) to give short term cover against the impact of such shocks on countries' revenue."

(Council conclusions of 24.05.2005)

8 Global Public Goods

"The Council calls on the Member States and the Commission to strengthen their action on global public goods (GPG) through enhanced collaboration and alliance-building with developing countries."

(Council Conclusions of 15.05.2007)

“[The Council will examine], on the basis of the report of the Task Force on Global Public Goods, the possibilities to establish by 2006 an Action Plan at EU level on the provision of priority International Public Goods (IPGs) and agreeing to examine the financing modalities of the IPGs.”

(Council conclusions of 24.05.2005)

9 Reform of the International Financial System

“The EU will …promote the enhancement of the voice of developing countries in international institutions.”

(European Consensus on Development)

- “[The Council will promote] a joint European position on enhancing the voice of developing and transition countries and further improving the quality of existing EU coordination in the IFIs.”

(Council conclusions of 24.05.2005)

10 Aid for Trade

On 15 October 2007, the Council adopted an EU Aid for Trade Strategy[13] and decided to review progress in implementing the Strategy in the context of the Monterrey reporting. The strategy contains most of the EU commitments regarding aid for trade.

“Within their commitments to future increases in development assistance, Member States will strive to increase the EU’s collective spending on trade-related assistance …to €1 billion per year by 2010, inclusive of spending on the enhanced Integrated Framework. This would bring the contribution of the EU as a whole, including the Community contribution, to €2 billion per year by 2010.”

(Council Conclusions on Trade Related Assistance:12.12.2005)

[13] http://register.consilium.europa.eu/pdf/en/07/st13/st13070.en07.pdf

Annex 2:
The Commission's monitoring mandate and the methodology used for the preparation of this progress report

Reporting in response to a comprehensive mandate from the Council:

In 2002 the Council mandated the Commission to monitor EU progress on the joint commitments on financing for development and aid effectiveness. When the Council agreed in 2005 to extend and further develop the EU's initial commitments of 2002, , it also reaffirmed the Commission's monitoring mandate, asking for annual progress reports to be submitted. The objectives of monitoring are to assess progress achieved, provide recommendations on overcoming any shortcomings and suggest how the EU could further contribute to advancing international financing for development. In its Conclusions of May 2007 and October 2007 the Council further requested that the Commission should report on progress regarding the implementation of the Code of Conduct on Division of Labour in Development Policy and the implementation of the EU Aid for Trade strategy in the context of the annual "Monterrey report".

Survey methodology

Since 2002, the Commission has collected information on the performance and views of the EU Member States on the different commitment themes through a detailed **annual survey**. The Commission is pleased to note the **Member States' ever-increasing ownership of and confidence in the monitoring process**, in terms of:

- **responsiveness**: as from the first questionnaire sent out in 2002, all Member States in the enlarging EU have responded;

- the **timeliness** of replies: overall, Member States have endeavoured to provide their contribution more promptly, with the help of close contacts with and encouragement (help-desk type support) from the relevant Commission department and, as and when necessary, extension of initial deadlines;

- the **comprehensiveness and quality** of responses: Member States vary in their technical capacity to deal with the financing for development issues covered by the EU commitments, some of which are complex and technical. Capacity depends on the overall size of Member States' development administration, the expertise available in the administration and their cumulative experience of development cooperation. While some Member States have a long tradition of development cooperation, others have only recently emerged as donors. Despite these disparities, all provide increasingly comprehensive replies, albeit necessarily diverging in quality. The Commission especially appreciates the efforts of those Member States that have joined the EU more recently with nascent development cooperation capacity. In some cases, a single task manager endeavours to provide a full picture of certain topics. The contributions of Member States with greater development experience reflect the involvement of a range of experts/services/ministries/agencies.

Over the years, the Commission has adapted the **methodology** applied in the **design of the annual questionnaire** and has also acknowledged that analysing the replies has turned into a substantially more time-consuming exercise for what are now 27

EU Member States. As a result, there has been a move away from many 'open' questions, as it is more difficult to assess and compare 'open' replies, to more 'semi-open' questions – where a range of pre-defined answers is offered (multiple choice questions) – or 'closed' questions (requiring yes/no answers). There are questions on all thematic commitments, organised in sections that each include a free space for comments so that Member States can contribute as they wish. The **latest survey** was **sent to the Member States at the beginning of November 2007;** the last reply was received by mid-February 2008.

Assessment of the questionnaire by Member States:

Member States were asked to assess the format of the questionnaire. Most of them agreed that the focus was right, i.e. ODA volumes, joint programming, aid for trade and global public goods (GPGs). However, 14 MS felt that there were too many questions (up from four in 2007), and 12 thought questions were too difficult (up from one), although only eight requested more background information (down from nine). When asked whether important issues where covered, there were indications that the survey should cover more aspects of aid effectiveness, aid to LDCs and states in a situation of fragility, and international stakeholders in development.

Methodology for the analysis of ODA

- Figures on Official Development Assistance (ODA) are in current prices. For 2007 ODA figures are based on Member States' replies to the Monterrey Survey and on the preliminary ODA results 2007 published by the OECD Development Assistance Committee (DAC) in April 2008). For previous years (2004-2006) figures were taken from the OECD DAC for those Member States that report to the DAC. For those Member States that do not report ODA volumes to the DAC, figures for previous years (2004-2006) were taken from Member States' replies to the Monterrey Survey.

- From 2008 onwards, ODA figures are based on available indications of Member States in the Monterrey survey 2008. For Members States which provide ODA figures in national currencies the Commission's annual average exchange rates for the respective years have been applied to convert them into Euro. Up to 2009, the exchange rates have been taken from the Commission's autumn 2007 forecast and, beyond that, nominal exchange-rate stability is assumed. Where a Member State presents only the ODA/GNI ratio, ODA is calculated by multiplying it by the Commission's GNI figure.

- Where a Member State gives both, the absolute ODA amounts and the ODA/GNI ratio, preference is given to using the ODA figure. **The ODA in absolute amounts gives a better indication of where the achievement of ODA/GNI targets is sensitive to differing assumptions on GNI. The Commission's GNI forecasts/ projections** are used for the individual Member States.

- When ODA is not available either in amounts or in ODA/GNI ratio, it is assumed that the ODA/GNI targets for 2010 (0.51% for EU 15 Member States and 0.17% for Member States that joined the EU after 2002) and 2015 (0.7% for EU 15 Member States and 0.33% for Member States that joined the EU after 2002) will be achieved. These ODA/GNI ratios are multiplied by the Commission's GNI

figures for the individual Member States to calculate the ODA in total amounts. For the remaining years a linear increase of ODA has been assumed and the absolute difference between the ODA amount of the latest year, for which information was provided, and the volume required to meet the 2010 and 2015 targets has been distributed equally over that period.

- Figures for Gross National Income (**GNI) in current prices** are outcome for 2006, estimates for 2007 and the Commission's autumn 2007 forecast and February 2008 interim forecast for the years 2008 and 2009. GNI figures for 2010 to 2013 are calculated by applying the Commission's country-specific projections of nominal GDP growth rates. The Commission's projections are based on potential output growth estimates until 2013 which were also used for the purpose of budgetary calculations in the context of the EU financial framework 2007-2013.