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Opinion

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Where Europe Stands in the New Aid Architecture and Why We Need a New €5bn European MDG Fund

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'As Europeans, we can be proud of our collective contribution to 2005, the year of international development.'

As Europeans, we can be proud of our collective contribution to 2005, the year of international development. In particular, we should celebrate the commitment to increasing aid, which is shared internationally, but is at heart a European achievement: 80% of the new commitments required to double aid by 2010 have come from European countries. We should also celebrate the new pledges donors have made to work together in support of developing country plans and programmes, the so-called Paris agenda on harmonisation and alignment.

As Europeans, we should also be aware, however, that the hardest decisions may yet be to come, in particular about the changing shape of the international aid industry. Our particular question is, of course, about the extent of commitment to the collective European project. Do we think that cooperation between national, bilateral agencies under the umbrella of the Paris declaration is sufficient? Or will we move instead to channel a larger share of a growing budget to Brussels?

The right answer to the first question is a conditional 'no'. The right answer to the second question is a conditional 'yes'. But the conditions for getting to 'yes' are not yet all in place. The task we face in 2006 is to make sure they are.

We will come to the conditions shortly, but, quickly, as a prior step, to unpack the argument.

First, aid is already increasing rapidly and will increase further – not immediately to the ultimate target of 0.7% of rich countries' GDP, but certainly in that direction. Figure 1 summarises the projections. It shows aid stagnating at around $US60 bn per annum through the 1990s, rising to $100bn p.a. by 2005 and continuing to rise steadily to $130bn p.a. or 0.36% of GNP by 2010 – all this in real terms. Of the total increase of $US48bn p.a., $US38bn p.a. in real terms will come from EU members, including $US8bn p.a. from Germany, $US7bn each from the UK and Italy, and close to $US6bn from France. A key moment in 2005 was the announcement by the European Council in May of new targets for aid: a collective a target of 0.56% of GNP by 2010, on the road to 0.7% by 2015, with old member states committing to a minimum of 0.51% and new member states endeavouring to reach 0.17%, both by 2010.

Some critics have argued either that planned increases largely consist of 'phantom' aid, like expenditure in aid-giving countries on refugees in their first year of residence, or unnecessary and unnecessarily expensive technical cooperation. Good point, though often exaggerated: aid should be appropriate, untied and directed to the needs of the poorest in developing countries. Other critics have argued that there will be big problems with absorptive capacity and that quality will inevitably decline; again, a genuine but avoidable risk if aid is spent well. More generally, however, it is important to remember both the human need to which aid responds, and the accumulation of evidence that aid, used well, is good for both growth and poverty reduction. We should not let our undoubted enthusiasm for continuous improvement blind us to the very considerable achievements of 2005.

Second, the Paris agenda on harmonisation and alignment, agreed at the Development Assistance Committee of the OECD in March 2005, does offer significant progress towards simplification of aid and better coordination between aid donors. In particular, it lays down concrete targets: for example, that 66% of all country analytical work by donors be joint with others or that 90% of donors use the public financial systems of recipient countries, rather than imposing their own procedures.

Third, however, this still leaves the aid industry as a vastly complex amalgam of agencies and programmes, which enormously complicates relationships and increases transactions costs. Complexity is increasing, with the creation of new global funds and special purpose vehicles like the pilot International Financing Facility for immunisation (IFFIm). Speaking in London recently, the UK Secretary of State for International Development, Hilary Benn, observed that there were 23 different UN agencies working on water, and that there were more than 90 global health funds. 'Last year', he said, 'we made promises on

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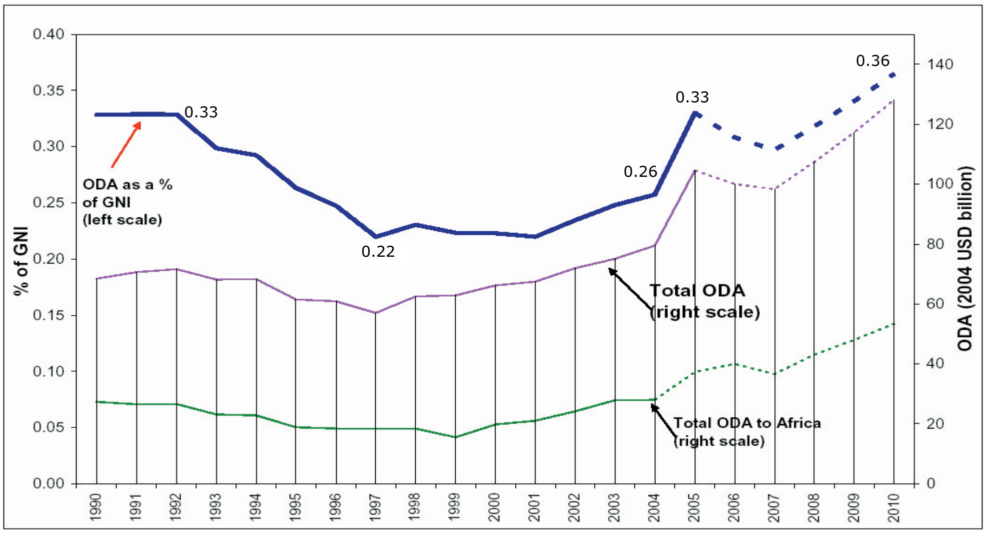
DAC Members' net ODA 1990–2004 and DAC Secretariat simulations of net ODA to 2006 and 2010 (Source: OECD DAC 2006)



The European Commission as a major player? Some would say it already is, given the size of its operations (7bn euros of official aid in 2004), the breadth of its scope (trade and foreign policy as well as aid), and its tapestry of treaty obligations, as for example in the Cotonou Convention. On the other hand, the Commission only accounts for about 20% of all aid from European countries, with most (about two thirds) still being bilateral, and the rest being channelled through the UN or the multilateral development banks. The multilateral share varies a great deal between countries: in the case of Italy, for example, it is close to three quarters, in the case of Sweden only a quarter.

Europe's apparent reluctance to channel more money through its own multilateral channel is at first sight surprising. Even more surprising is the observation that the share channelled through the EC is likely to decrease, unless active steps are taken to maintain the EC's market share. With the European Development Fund fixed in monetary terms, and the recent budget settlement fixing the size of the external budget to 2013, there seems to be little scope for the EC to absorb its share of increasing aid volumes.

If current trends are to be reversed, European countries will need: (a) a good understanding of the role that the Commission can play; (b) a realistic appreciation of what needs to be done to improve capacity; and (c) a willingness to bring about change.

aid that the international system as it currently stands is not equipped to handle well'.

Walmart and the corner shops

In thinking about the structure of the aid industry, a useful analogy is with the supermarket sector in groceries. We have described the aid industry as looking like Walmart on one side of the street and a whole string of corner shops on the other – where Walmart is the World Bank, dominant because of its financial muscle but also its intellectual resources. By comparison with the World Bank, every other agency, including the European Commission, is a corner shop. And the point of the analogy is to say that an industry structure characterised by one giant and many small players is certainly inequitable and likely to be unsustainable. Any market regulator in an advanced industrial economy would insist on more diversity and more competition.

Conventional wisdom would argue that there should be at least three major players. The World Bank should be one. This is not an attempt to undermine the Bank, or to reverse the new commitments that were made last year to the IDA.

The UN is already a large player, of a particular kind, and has the universality of mandate, the geographical coverage and the legitimacy to be the second member of the triumvirate. The UN development and humanitarian system is currently under the spotlight from the Secretary General's High Level Panel on System Wide Coherence, and no doubt changes are needed in organisation and finance. In particular, the UN needs a new funding window – but that is another story.

The EU could be a third leg. It offers the possibility of economies of scale over the many bilateral programmes of member states, and has other advantages, linked to its trade and foreign policy mandates. Those advantages are linked particularly to the role of the Commission as a development actor.

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A global role for the EC

As far as the role is concerned, there has been a long-standing ambivalence about whether the EC aid programme should be genuinely comprehensive or should try to fill niches that the member states have left vacant. Do we want the EC to undertake activities that member States might also undertake, but perhaps undertake them better or on a larger scale? Or should the EC concentrate on sectors or activities that member states find difficult, because they lack skills or resources. As an example of the latter, large infrastructure projects are often cited as an example of niche products for the EC.

The new consensus on development policy, signed in February 2006 by the Council, the member states, the parliament and the Commission ought to dispel the ambivalence. It begins with a summary of a European consensus on development, which defines common objectives, values and principles, and discusses how to deliver better aid. It then turns to the 'particular role and comparative advantage' of the EC, and identifies seven elements of what might be thought of as the EC's unique selling point. These are:

- A global presence;

- A focus on policy coherence, especially with respect to trade;
- Promoting development best practice;
- Facilitating coordination and harmonisation;
- As a delivery agent where size and critical mass are or special importance;
- In promoting democracy, human rights, good governance and respect for law; and
- In working with civil society.

This sounds like a prescription for the genuinely comprehensive agency, working at scale, across sectors and around the world: a genuine counterpart to the World Bank. The prescription is somewhat undermined, however, by the next section of the document, which seems to derive from a niche mentality and identifies areas of concentration for the EC: trade and regional integration; the environment and natural resources; infrastructure, communications and transport; water and energy; rural development, agriculture and food security; governance and institutional reform; conflict prevention and fragile states; human development; gender equality; and HIV/AIDS. The saving grace of this list is that it is itself comprehensive, at least internationally, even if some specialisation is foreseen at country level. Is anything missed out? Perhaps what we have here is a characteristic and unsatisfactory European compromise: a stated desire for specialisation, but a reluctance to take the decisions which would make that possible.

Never mind, a global player should not be tied by sectoral specialisation and the niche approach is inappropriate if the overall focus is on reshaping global aid architecture. Let us assume, then, that the various players have signed up to a vision which would allow the EC to match the World Bank. Why, then, not stand the aid architecture on its head – instead of providing only 20% of European aid through Brussels and 80% through other channels, how about 80% through Brussels and 20% bilaterally and through other channels?

Improving capacity

The reluctance of member states to pursue this option is partly rooted in politics, no doubt, but also in worries about capacity.

On the political side, member States have long been reluctant to cede sovereignty over development policy to Brussels. It is carefully identified as an area of shared competence between the Commission and Member States. Development policy, after all, still has political implications.

On the side of capacity, the EC has been regarded by most member states as delivering aid which is below the quality of their own programmes and often at higher cost. That may or may not be true – there is little comparative evaluation. In any case, things may be beginning to change. The EC has undergone substantial reform since 2000, with: the creation of EuropeAid as a single implementing agency; rapid decentralisation; a shift to budget support as a more cost-effective form of aid; and a commitment to harmonisation and alignment. The new Financial Perspectives, which set the budget for the EU to 2013, also offer the prospect of legal simplification, with fewer instruments. It may be too soon to say that the EC is now on a par with the best bilateral development agencies in Europe, but the mood music is changing. To cite Hilary Benn once more, representing a country that has traditionally been sceptical about the development value-added of the EC, 'it is clear that in the future, what the EU does will be central to our chances of achieving progress . . .'.

This does not mean that the reform agenda is exhausted: far from it. The organisation of the Commission services remains sub-optimal, with EuropeAid existing separately from the Directorate General for Development, and with the Commissioner for Development not having full control of all aid policy. In addition, too much money is still spent on countries which are not the poorest, especially the 'ring of friends' in the Balkans, Eastern Europe and the Mediterranean.

In one other area, the EC clearly falls behind the World Bank, which is its capacity for analysis. In another context, I have made the point that to be a global player requires strong research and policy capacity, and asked 'how many divisions has the Pope?'. The answer is not many 'inside the house', but very many outside. Europe has the largest concentration of development expertise in the world, for example in the institutions which make up the membership of EADI, the European Association of Development Research and Training Institutes. The challenge facing the Commission is how to make better use of this capacity, and there is an intriguing paragraph in a recent Commission Communication to the Council on the subject of 'EU Aid: Delivering More, Better and Faster'. It says that

> 'While European centres of excellence in the area of development have produced strong academic contributions, they nevertheless seem scattered in nature. This lack of "unified" European research and academic works has hampered our impact on the general thinking in this field. It is therefore important to better connect these centres, in a flexible network and on a pro-active basis. Such a network should be established by 2006 to commission strategic studies that would feed our own thinking and strengthen our academic input to global thinking. It should allow by 2008 a comprehensive EU prospective and analytical capacity.'

The EU Council picked this up at its meeting in Luxembourg in April 2006 and welcomed the Commission's proposal. This is certainly an initiative to be watched.

Reward progress and provide the incentive to do more

To summarise, we can agree that there is beginning to be a vision of the global role the EC might play in a new aid world, and that capacity is increasing. Neither project is complete, and there remain significant

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problems with the way the Commission is structured and with the high share of aid spent on countries which are not among the poorest. Nevertheless, there would seem to be a case for rewarding progress and providing incentives to improve further – perhaps not moving to 80% of all European aid through the Commission, but certainly enabling the Commission to maintain its market share and perhaps increase it over time.

Simple arithmetic will illustrate the size of the task. On DAC figures, total European aid will reach $US81bn by 2010. If the Commission were to retain a 20% share of that flow, it would need to be spending $US16bn per annum or some 13bn euros at 2004 prices, twice the current level. If the EC's share were to increase to, say, 40%, then its annual expenditure would have to rise to 26bn euros. These are growth rates of 20% and 40% a year, infeasible under current budgetary arrangements. For example, the Financial Perspectives foresee growth in all external action, including aid to pre-accession states and to Europe's immediate neighbours, rising only to 8.1bn euros in 2013, a maximum 30% increase over six years compared to the starting figure. These figures exclude the European Development Fund, but that has been fixed at about 22bn euros over five years to 2013 in the 10th. EDF, which is an increase from the previous figure of 13.5bn euros, but only 15% in real terms in total over five years – not enough, and anyway restricted to ACP countries.

A better option might be to set up a special fund, open to poverty-reducing activities in all poor countries, and governed in a transparent and accountable way.

Member states are unlikely to want to revisit the Financial Perspectives, and are also unlikely to want to expand the EDF in the relevant timeframe. These views may change when the fundamental review of EC expenditure takes place, starting in 2008, and it may be that savings on the Common Agricultural Policy will enable development expenditure to increase. However, that is some way ahead and is unlikely to have a major impact on expenditure before the next Financial perspectives become operative in 2014.

The obvious conclusion, then, is that Member States need to design special-purpose vehicles, flexible and performance-related, that will enable them to channel more money through the Commission.

One option is favoured by the Commission, which is to introduce trust fund arrangements, for example to fund infrastructure. These, however, have the disadvantages of adhoc funding. They also raise questions of accountability. Would the European Parliament have oversight over trust funds? Or would the institutions of the ACP?

A second option is to open the 10th European Development Fund to supplementary funding, but this suffers from the disadvantage that the EDF is not available to many countries in Asia where the majority of the world's poor are to be found, or come to that to poor countries in Latin America.

A new EC MDG Fund

A better option might be to set up a special fund, open to poverty-reducing activities in all poor countries, and governed in a transparent and accountable way. This might be called the European MDG fund, and might aim to spend at least 5bn euros a year initially, in order to maintain and slightly increase the EC's market share. Donors could contribute to the Fund on a voluntary basis.

Three conditions would have to be met for the new Fund to be established.

First, it would need to be conditional on demonstrated capacity within the Commission, including capacity to commission and use research, analysis and policy development. Comparative evaluation across donors would be a good way to test the EC's comparative competence. The promise of new money might also be a way to leverage change in the structure of the Commission. Member States could ask for comparative evaluation, policy development and a phased reform programme, and could tie replenishments of the fund to progress against agreed milestones.

Second, the Fund should clearly be directed to the poorest countries, and should remedy the current biases both to the ring of friends and to ACP countries. In particular, the Fund might be a way to overcome the relative neglect of Asia in EC development programmes. A transparent formula should be adopted.

Third, management of such a fund should conform to best-practice, and demonstrate accountability both to European tax payers and to developing countries. For this reason, a solely budget-based solution would not be appropriate, because although it would provide accountability by the European parliament, the developing country voice would be missing. Instead, it would be interesting to explore how the institutions of the ACP could provide a model, with joint parliamentary assemblies and joint Councils of Ministers. However, it would be important to include non-ACP countries in the arrangements. Perhaps non-ACP members could be invited to participate in ACP meetings as observers, with special sessions on the Fund in which they would have voting rights.

There are details still to fill in, obviously. But this is an ambitious vision for EC aid over the coming years: building on its past success to become a major player in the new aid architecture; acquiring new resources so as to maintain and increase market share; and deploying these in a new, model partnership with developing countries around the globe. Remember, that if we don't do something like this, the European role in the aid industry will inevitably shrink. More positively, however, and as Europeans, a new role and new Fund could make us truly proud.

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