Overseas Development Institute

Background Note

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Financing European development cooperation: the Financial Perspectives 2014-2020

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The Financial Perspectives (2014-2020) is the European Union's (EU) multi-annual financial framework review. It is one of a number of reviews that will shape the future of EU development assistance and the credibility of the EU as a major player in international development.

EU development aid and other policy expenditures are determined every seven years in framework budget reviews. This is equivalent to the government of an EU Member State undergoing a spending review for all areas of public expenditure. All aspects of the EU budget are up for negotiation.

The debate on the future priorities, financial allocation, instruments and structure of EU development cooperation takes place as the Lisbon Treaty's provisions to manage the EU's external policies are being shaped. Discussions will address two parallel budgetary structures for EU development cooperation.

EU development assistance is resourced from both the EU budget (around 70%) and the European Development Fund (EDF – around 30%). The EDF is an inter-governmental agreement of the EU Member States, based on their voluntary contributions. Consequently the management of the EDF and its resources are not the same as for the EU budget, where the European Parliament has a co-decision role together with the Council.

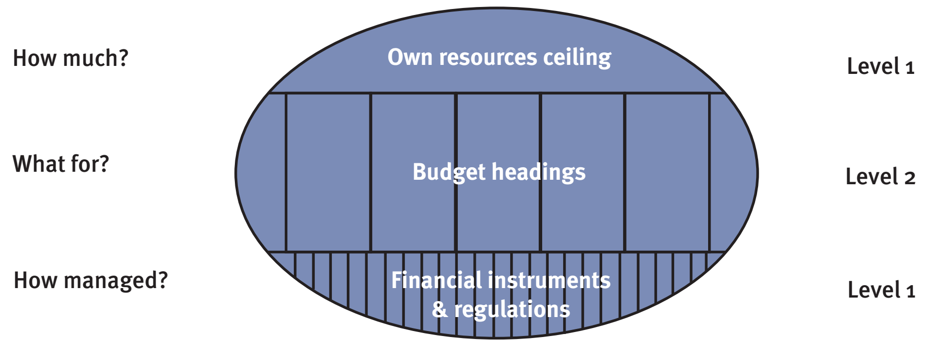
The approach

There are three fundamental questions about the future funding of EU external actions (Figure 1):

1. How much funding is there, overall, for the EU budget?
2. What should it be spent on?
3. How should it be managed?

'How much?' relates to the European Commission's 'own resources' ceiling, or transfers made by the Member States to the Community budget to cover EU expenditure. The EU budget is financed mainly through a uniform percentage rate applied to the total GNI of all Member States up to a ceiling fixed at 1.24% by a Council Decision and adopted under the

Figure 1: Three key questions about funding EU external action



Source: Author's construct.

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EC/Euratom Treaties. Other forms of 'own resource' include agricultural duties and sugar levies; customs duties; and a uniform percentage rate to the VAT base of each Member State – approximately 0.5%.

'What for?' relates to the budgetary headings and the breakdown of expenditure between the headings. The classification of Community expenditure in the headings reflects the various policy choices. The breakdown of total expenditure between the various headings should, in principle therefore, revolve around the main political priorities adopted for the period. The process also establishes the total allocation under each heading of the EU budget, and the room for annual variations.

'How managed?' relates to the financial instruments under each heading and the regulations that govern the spending of the instruments.

Looking back: The Financial Perspectives 2007-2013

The main political priorities for the EU during this seven-year period were set as:

- the completion of the internal market
- the completion of an area of freedom, justice, security and access to basic public goods – the political concept of European citizenship
- the projection of Europe as a coherent global partner

There were five budget 'headings' that related to these priorities:

- Heading 1: Sustainable development: Competitiveness and cohesion for growth and employment
- Heading 2: Sustainable management and protection of natural resources
- Heading 3: Citizenship, freedom, security and justice
- Heading 4: The EU as a global partner
- Heading 5: Administration

The Commission also elaborated a new way of governing and managing its funding instruments. The new approach entailed a large reduction and rationalisation of the funding instruments. Under Heading 4, a radical overhaul resulted in a consolidation of more than 30 overlapping financial instruments to just 10. Separate instruments were created for development cooperation in Asia, Latin America and the Middle East and neighbourhood policy (See Box 1 and Figure 2). In addition to the geographic instruments, the thematic instruments prioritise the list of EU global objectives. Unlike the geographic instruments, which in principle, are supposed to be based on shared analyses of local needs and conditions and joint response strategies, the thematic instruments are based on the EU's own strategic considerations and priorities. They mix official development assistance (ODA) and non-ODA funds.

Both the Development Cooperation Instrument (DCI) and the European Neighbourhood and Partnership Instrument (ENPI) contain a set of cross-cutting thematic programmes which are applicable to all developing countries (including those that are members of the African, Caribbean and Pacific (ACP) Group of States). Although the DCI and ENPI are not based on joint analysis of the priorities of developing countries, they must be consistent with the overall objectives, principles and policy prescriptions of the two instruments. According to the DCI Regulations, ODA must account for 95% of the DCI on average

Box 1: The financial instruments for EU external action

Budget:

Geographic:

- Development Cooperation Instrument (DCI, €16.9 billion, 2007-2013): Asia, Latin America, Central Asia, the Middle East and South Africa. This instrument also contains thematic programmes covering specific activities in all developing countries.
- European Neighbourhood and Partnership Instrument (ENPI, €11.2 bn, 2007-2013): European neighbourhood and Russian Federation.
- Instrument for Pre-Accession (IPA, €11.5 bn, 2007-2013): EU accession countries.
- Instrument for Cooperation with Industrialised Countries (ICI, €172 million, 2007-2013).

Thematic:

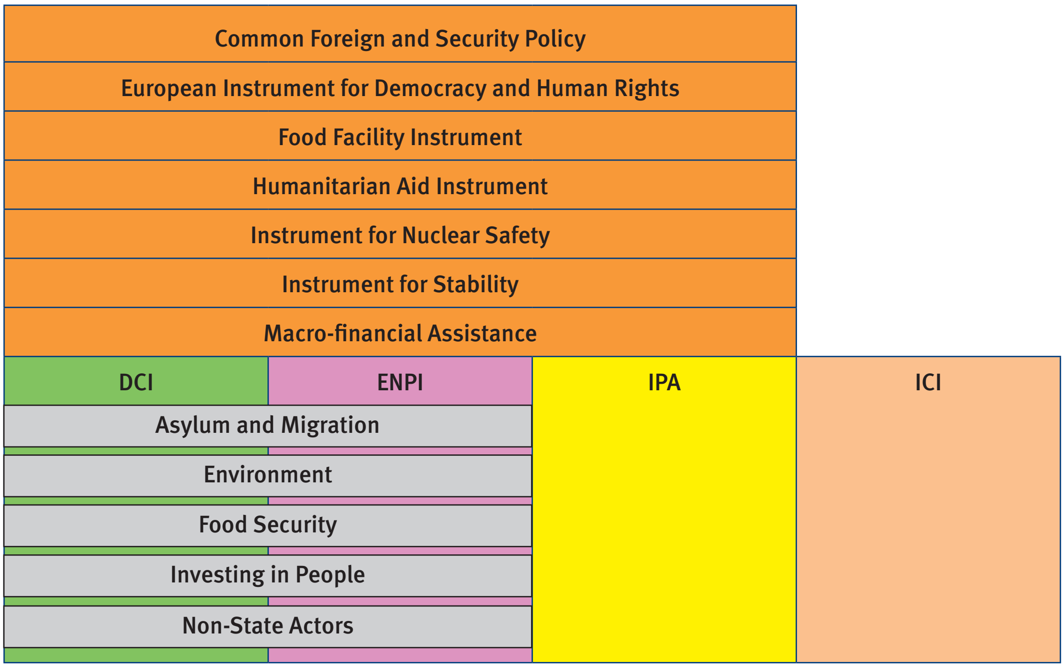
- Common Foreign and Security Policy (CFSP, €2 bn, 2007-2013).
- European Instrument for Democracy and Human Rights (EIDHR, €1.1 bn, 2007-2013): promoting democracy and human rights worldwide.
- Food Facility Instrument (FFI, €1 bn, 2009-2011): enabling a response to problems caused by soaring food prices in developing countries.
- Humanitarian Aid Instrument (HAI, €5.6 bn, 2007-2013): providing funding for emergency and humanitarian aid relief and food aid.
- Instrument for Nuclear Safety (INS, €524 m., 2007-2013): ensuring nuclear safety.
- Instrument for Stability (IfS, €2.1 bn, 2007-2013): tackling crises and instability in third countries and trans-border threats.
- Macro-Financial Assistance (MFA, €791 m., 2007-2013): promoting macroeconomic stabilisation and structural reforms.

Non-EU budget:

- European Development Fund (EDF, €22.7 bn, 2008-2013): Africa, Caribbean and Pacific and Overseas Countries and Territories.

Source: Author's construct.

Figure 2: EU budget external action instruments and programmes



Source: Author's construct.

(100% of the geographic programmes and 90% of the thematic programmes). Yet, there is significant pressure to use the thematic programmes for EU priorities beyond development, such as migration.

Heading 4 represents around 5.7% of the total EU budget (approximately €56 bn for 2007-2013).

Looking forward: The negotiations on the Financial Perspectives 2014-2020

The timeline

On 19 October 2010, after a delay of almost two years, the European Commission published its Communication on the EU Budget Review. The Communication puts forward a set of policy priorities for the next seven-year multi-annual financial framework and recommendations to address the current obstacles to the greater efficiency and effectiveness of the EU budget. It paves the way for the Commission's proposals for the next Financial Perspectives 2014-2020, due before July next year, and which will propose a figure for the EU's own resources ceiling and amounts for the budgetary headings. At around the same time, the Commission is expected to submit formal legal proposals on detailed reform of the Common Agricultural Policy (CAP) for negotiation by EU Ministers. The negotiations are expected to continue well into 2012, and need to be completed by early to mid-2013 (see Figure 3 overleaf).

The European Commission's proposed priorities

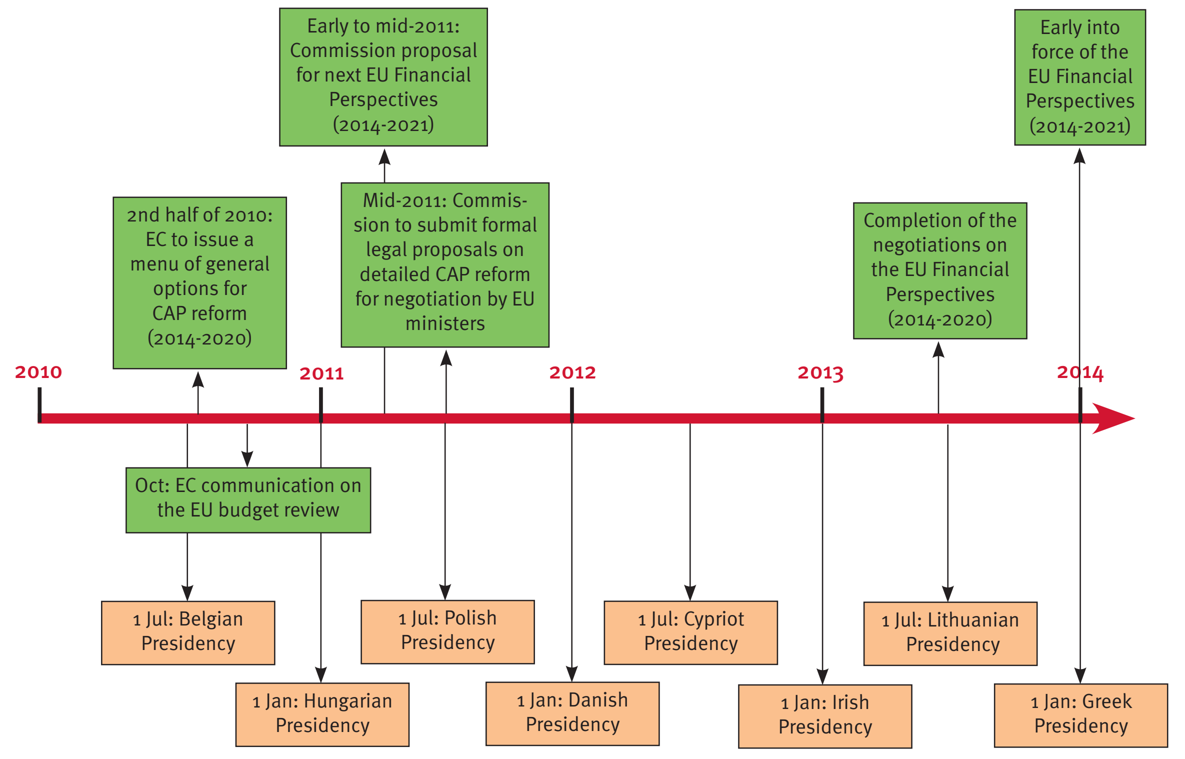
According to the Commission, the weaknesses of the EU budget are:

- a lack of flexibility: the budget is too slow to react to unforeseen circumstances and changing demands, with the current rules for shifting funds being long and cumbersome.
- a lack of focus on European priorities: the nature of the debate leading up to agreement of the financial framework has, in the past, been guided by 'net balances' and 'fair returns', rather than on adequately funding European priorities.
- severe delays: in particular, in launching programmes due to the complexity of the process.
- input over performance: programmes are assessed on the basis of input rather than performance.

The policies put forward by the Commission are:

- **smart, sustainable and inclusive growth**, with a focus on research, innovation, education, infrastructure, energy and climate, reform of the CAP, and cohesion policy.
- **citizenship**, including cultural diversity, fundamental rights, justice, security, and asylum and migration.
- **pre-accession support**, for closer integration of candidate and potential candidate countries through the enlargement process.
- **a global Europe**, reinforced through a focus on poverty alleviation and the achievement of the

Figure 3: Timeline of the EU Financial Perspectives (2014-2020) negotiations



Source: Author's construct.

Millennium Development Goals, the promotion of good governance, regional cooperation and economic development, better effectiveness and impact of aid, blending loans and grants, partnerships with middle-income countries (MICs) and emerging economies, delivering climate finance commitments, responding to crisis situations, migration, combating terrorism and organised crime, humanitarian aid, and supporting the neighbourhood region.

- **administrative expenditure**, including funding the European External Action Service, and containing expenditure through rationalisation and common use of procedures, tools and resources.

The Commission also proposed expanding the financial framework to 10 years with a major mid-term review after five years, greater leveraging of investment through European Investment Bank (EIB) loans, increasing reserves, transferring funds and unspent margins to ensure greater flexibility, front- and back-loading of funds, and increasing the size and scope of flexibility instruments. Finally, the Commission put forward a proposal to abolish the VAT-based 'own resource' and replace it with one of six options: a financial transaction tax, auctioning of greenhouse gas emission allowances, an airline tax, a separate EU VAT rate, an EU energy tax or an EU corporate income tax.

Questions at level 1 (own resources)

What should be the size of the EU budget? A highly contentious and political debate, the negotiations on the overall size of the EU budget are expected to be even more so in the wake of the economic crisis that has ushered in an era of austerity across Europe. The conclusions of the European Council meeting in October 2010 state: 'Heads of state or government stressed that, at the same time as fiscal discipline is reinforced in the European Union, it is essential that the EU budget and the forthcoming [long-term budget] reflect the consolidation efforts being made by Member States'.

Questions at level 2 (budget headings and expenditures)

How should spending be divided across EU priorities? Once the overall amount has been set, the next stage is to set the ceilings of financial commitments for each of the different budget headings.

New priorities that will need to be funded include the new post-Lisbon Treaty institutional arrangements and, in particular, the creation of the European External Action Service, climate change mitigation and adaptation activities, research and development, and conflict prevention and crisis management. All of these will be in competition with traditional priorities such as agriculture, structural funds, pre-accession funding, neighbourhood policy and migration management.

Various options to redirect funding to new priorities include: a reduction in agricultural expenditure (more than three quarters of the annual €57 bn farm budget is spent on direct support for farmers and market interventions to maintain prices) and a reduction in structural funds, which would lead to a conflict with all net recipients, in particular the Central and East European Member States. Other options include the adoption of a 'generalised correction mechanism' (i.e. a partial refund of the contributions to the EU budget for all Member States which exceed a threshold) which would affect the UK rebate. While no specific recommendations have been made on which sectors should have their funding cut, the Commission's budget review does call for a shifting of money to areas that promote 'smart, sustainable and inclusive growth ... such as energy and climate change'.

How to manage climate financing within the EU budget will be a critical decision in the upcoming negotiations, and a key question will be whether such financing will be additional to ensure that it does not divert resources from other development priorities. One option could be to have a separate budget heading for climate change although this could create coordination problems in implementation.

From a development perspective, how does one make the case for a redirection of funding from other priorities to aid? Options include:

- comparing the level of development assistance with other areas of the EU budget, such as administrative costs (just over €56 bn for the seven-year period).
- making the point that preserving high levels of Official Development Assistance (ODA) within the EU budget might help Member States to meet their 0.7% of GNI pledges on aid.
- comparing the relative spending effectiveness of the EU with the relative domestic spending effectiveness of Member States. The idea would be that even though a unit of EC aid might be less effective than Member State bilateral aid, its use might still be maximised (on the basis that total EU budget spending, total aid spending and total Member State contributions to the EU are all assumed to be fixed). The case for EU development aid would then rest on the relative value added of EU spending in development versus other areas.

Questions at level 3 (financial instruments and regulations)

Should there be a separation of instruments that are ODA-eligible and those that are not? The Commission has maintained that it wants to continue the process of streamlining the financial instruments that began in 2007. However, there is also a case for separating ODA and non-ODA instruments. For example, the DCI is a specific development instrument requiring at least 90% of funding under its thematic programmes and 100% of its geographic programmes to be ODA-eligible. Yet, programming documents issued by the Commission under the DCI lack the clear focus on poverty eradication, sustainable development and the MDGs, that the DCI cites as its primary and overarching objective (Mitchell, 2009). The wide coverage of the DCI (including least developed countries, low-income countries and middle-income countries) poses a big challenge. Separating ODA and non-ODA instruments could be done through a proposal for a minimum and maximum share of the external actions budget that has to meet the ODA criteria set by the OECD Development Assistance Committee (DAC).

How can the financial instruments and regulations be made more coherent with each other? Looking at the Instrument for Stability (IfS), although its goals and those of the Africa Peace Facility are similar, and even almost identical, the former is part of the EU budget and the latter is funded via the European Development Fund (EDF). Reducing the number of different financing instruments for similar activities would increase the chances of policy coherence.

Should the EDF be budgetised? The entry into force of the Lisbon Treaty brought with it the necessary changes enabling the decision for incorporating the EDF within the EU budget ('EDF budgetisation') to be made by a simple decision of the Council. The long-standing debate on budgetisation of the EDF will, once again, come to a head during the discussions between Member States on the Financial Perspectives.

Both the European Commission and the European Parliament have been strong proponents of budgetisation. The Commission has consistently maintained that incorporating the EDF within the EU budget would result in simplified procedures and increased effectiveness and efficiency of EC aid. The European Parliament has tended to favour budgetisation as it would increase their role in overseeing the management and use of EU development assistance to African, Caribbean and Pacific (ACP) countries. The Commission failed in its last attempt at budgetisation, during the 2007-2013 Financial Perspectives negotiations for two main reasons.

First, some Member States opposed budgetisation. For some, it would have entailed an increase in their share of contributions to the EDF as it became based on a percentage of GNI rather than on voluntary contributions. Others were reluctant to put the strong poverty focus of the EDF at risk by integrating it into the EU budget where funds have the potential to be captured by different priorities (90% of EDF resources go to low-income countries in contrast to under 40% of aid from the EU budget development instruments). Second, although a strong proponent of budgetisation, the European Parliament was reluctant to take it forward without a clear commitment from the Member States to increasing the overall budget in order to safeguard EDF resources.

Arguments in favour of budgetisation include:

- the almost complete harmonisation of EU budget and EDF administration
- the fact that 20% of aid to the ACP countries already originates from the EU budget
- the fact that an all-ACP geographic strategy has become redundant, as aid programming takes place at a regional and national level including the three regional strategies for Africa, the Caribbean and the Pacific, and the strategies for sub-regions of Africa
- the lack of democratic control and parliamentary scrutiny of a €22.7 bn pot of money over six years for the ACP.

The European Parliament's Development Committee now has the right of scrutiny of Country Strategy Papers and National Indicative Programmes for Asia and Latin America, under the DCI. The EDF, being separate from the EU budget, prevents the European Parliament from exercising a similar role for the programming of the ACP Country Strategy Papers. This will become even more pressing once the European External Action Service comes to play an important role in development programming.

The contribution to the EDF of each EU Member State is determined by a different proportional basis to their contribution to the EU budget. This means that for some Member States the integration of the EDF into the EU budget would increase the contribution that they are required to make, while for others it would diminish. As EU budget resources will continue to be scarce, it will be very difficult to source the extra commitment represented by the EDF especially after Member States have prioritised expenditure that will give a return on their money.

Arguments against budgetisation include the loss of aid predictability and aid quality. While the EU budget is established on an annual basis by the Budgetary Authority (the Council and the European Parliament), the EDF is established for a six-year period with the contributions being provided by the Member States as they are needed. Under the annual budget process, the level of commitments and disbursements that are possible are defined both by the terms of the financial perspectives and the budget adopted for the year.

This principle of 'annuality' poses the risk that the disbursement rate will become a more important factor than the quality of actions supported in the management of EC aid to the ACP. Increasing disbursement will require political will and additional human resources if this large sum of money is to be disbursed efficiently.

Another argument against budgetisation is the potential for development money to be spent beyond the neediest countries (many of which are ACP countries) and on other purposes due to the fact that budget resources can be moved from one part of the budget to another.

Finally, budgetisation would mean the loss of the mutual accountability and political dialogue provisions, the joint institutions (such as the Joint Council of Ministers and the EU-ACP Joint Parliamentary Assembly) and arbitration procedures. It would also end co-management, such as the synergy of joint EU-ACP financial cooperation – joint programming, joint assessments, joint solutions – that makes the legally binding Cotonou Agreement a unique partnership contract.

To what extent can blending of loans and grants free up funds? Towards the end of 2008, the EU recognised the importance of blending mechanisms. In 2010, the Development Commissioner, Andris Piebalgs, said: '... blending becomes one of the answers for the future in meeting global development challenges ... They show great promise, as tools to increase the leverage and visibility of EU external assistance and promote cooperation among bilateral and multilateral finance institutions.' The European Invetsment Bank (EIB) acknowledged this, saying: '... blending of grants and loans is an effective way to maximise political and financial leverage and support EU policy objectives outside the EU' (Piebalgs, 2010).

Blending mechanisms are a response to the need to increase the volume of development financing in a context of constrained resources; to enhance the speed with which aid is disbursed; and to increase the flexibility with which it may adapt to the changing environment.

Blending offers the prospect of EU grant funding being freed up with possible reallocation to the neediest countries. The theory suggests that an effective and efficient blending instrument should involve lower grant shares in countries with higher incomes (other things being equal).

Issues at Level 3 will also include:

- a discussion on whether the thematic programmes

still reflect EU priorities and global challenges and whether they need restructuring.
- the need for flexibility within the EU budget as a whole, both across budget headings and instruments, in order to allow, among other things, for the EU to respond to crisis and natural disasters effectively and quickly. However, this will need to be balanced with the need to preserve the share of the budget designed for ODA.
- how values such as 'policy coherence for development' can be made a central feature of the debate on how the budget should be managed.
- a strong emphasis on value for money and demonstrating results.

Conclusion

In previous Financial Perspectives negotiations, external action has been considered of a lesser political priority. Consequently, the lower the EU's own resources ceiling, the more external action has suffered disproportionately from the restriction. Competing agendas have included the Common Agricultural Policy (CAP), structural and cohesion funds.

The new structures proposed by the Lisbon Treaty, including the role of the High Representative for Foreign Affairs and Security Policy/Vice President of the Commission, and the European External Action Service, as well as geopolitical alliances, trade interests and security imperatives, will all have considerable influence on the negotiations of the new Financial Perspectives. In the end, development aid will be constrained for the next seven-year period by the overall size of Heading 4 – the EU as a global partner – and the competing needs of other external action requirements.

The debate will also undoubtedly raise a series of questions about the future of aid in EU development policy including:
- its added value
- how narrow or wide its definition
- its geographical focus, and
- the extent to which it is prioritised amongst other external policies.

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Useful links:

European Commission, Financial Programming & Budget: http://ec.europa.eu/budget/budget_detail/overview_en.htm

European Commission, Reforming the Budget, Changing Europe: http://ec.europa.eu/budget/reform/index_en.htm

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