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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

Improving EU support to developing countries in mobilising Financing for Development.

Recommendations based on the 2012 EU Accountability Report on Financing for Development.

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1. INTRODUCTION

The EU has constantly been the driving force in mobilising international support for development: it is the largest aid donor and the leader in aid effectiveness, the largest and most open market for developing countries and is at the forefront promoting the three dimensions of sustainable development.

This standing has been achieved through a number of specific EU commitments to support developing countries in their efforts. Many of these contribute to the overall goal of helping developing countries to mobilise all sources of financing for development for achieving their development goals.

The international Financing for Development agenda, set at the Monterrey conference[1] in 2002 and taken forward at the Doha conference in 2008, is a crucial ingredient in all major international discussions on issues requiring global cooperation. MDGs, international climate action, sustainable development, international trade negotiations — they all touch on how to finance progress towards the goals set. Rightly so, as taking into account the available means is essential for setting realistic goals.

What are these means in the development context? By far the biggest source of financing for development available to governments is the domestic revenue — this also explains why the primary responsibility for development lies with the developing countries themselves. Aid from development partners complements this, and can catalyse other flows, but is in itself not the major element for many developing countries. It is, however, international trade, investments and money sent back home by migrants that can stimulate the real economy, given the right conditions. There are also outflows from developing countries, which need to be taken into account.

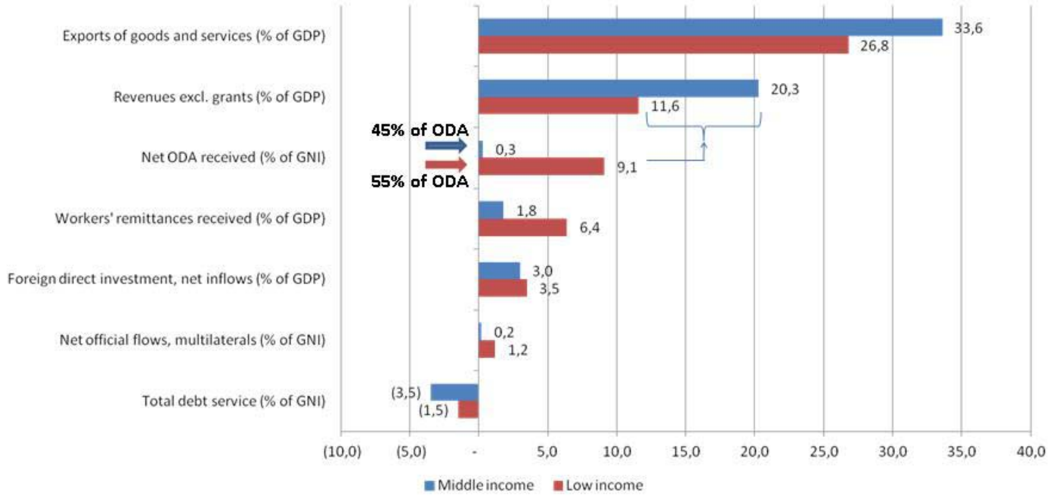
Still, donors have an important role in development and Official Development Assistance (ODA) matters. Firstly, donors can take action that supports or creates leverage for other development finance. Secondly, ODA is more important to the poorest countries, who have limited access to other sources. These two considerations also underpin the EU Agenda for Change.

[1] International Conference on Financing for Development.

At the same time, we need to look at all development finance — domestically mobilised finance, international inflows, and also outflows — as in reality developing countries have to design and implement their development policies taking into account the combination of the resources available.

The EU and Member States, in contrast to other donors, have made various commitments in all areas of financing for development and annually monitored our progress towards these.

Figure 1: Sources of Financing for Development (average 2007-2009)



Source: World Bank Global Development Finance

This Communication builds on the previous progress as well as the new principles set out in the Agenda for Change, and proposes improvements in EU support for mobilising development finance. These proposals are based on data presented in the Staff Working Document accompanying this Communication and the previous Reports published since 2003.

2. EU SUPPORT FOR STRONGER PUBLIC FINANCES IN DEVELOPING COUNTRIES

2.1. Increased Domestic Revenue Mobilisation

Domestic revenues tend to be the most important source of development finance directly available to governments. Considering that revenue collection levels[2] in developing countries, and more so among Low Income Countries, are clearly below the global average, this is one area where significant additional efforts should be made. Increases in government revenue can translate directly into increased investment on development priorities, which also underlines the responsibility for spending it well.

2 Usually expressed as tax-to-GDP ratio.

It is up to the partner government to enact and uphold the appropriate regulatory measures and policies to ensure that the virtuous cycle of tax collection-development spending-development progress-increased tax collection materialises. Donors can only facilitate this process if the partner government is ready and committed. In this spirit, the EU should continue to increase its support to strengthen the capacity of tax systems in line with the three principles of Good Governance in the tax area (transparency, exchange of information and fair tax competition) and public financial management.

***Actions**: The EU and its Member States should incorporate tax administration and fair tax collection, including rationalising tax incentives and good governance in tax matters, into policy dialogue with partner countries.*

In addition, donors can support developing countries in domestic revenue mobilisation by regulatory means. To combat illicit capital flows from developing countries, the EU contributes to improving transparency of international financial flows, e.g. by supporting capacity in identifying misuse of transfer pricing. These efforts are complemented by cooperation initiatives such as strengthening the Extractive Industries Transparency Initiative and adopting legislation for country by country reporting for multinational enterprises[3]. The EU and its Member States should continue these actions.

2.2. Maintaining Sustainable Debt Levels

Ensuring that debt is sustainable is an integral part of good management of public finances, including appropriate macroeconomic policies to ensure stability. The prolonged period of economic crisis has reduced the ability of many developing countries to respond to possible additional shocks[4], while also reducing the ability of developed countries to extend support.

The debt-management capacities of developing countries and their resilience against economic shocks should be enhanced further. The EU and its Member States have delivered on their debt-relief commitments and increased their level of involvement. The EU also monitors developing countries' finances in cooperation with the IMF, and supports reforms in public-finance management, including debt management.

In the light of the increased use of lending mechanisms for developing countries, and the increased share of non-Paris Club loans in developing countries' debt portfolios, the EU and its Member States should continue to promote responsible lending and borrowing practices, and encourage the involvement of all lenders in debt workout settlements. Five Member States have also taken specific action to prevent litigation by distressed-debt funds in respect of developing countries, and such measures should be expanded.

Actions: The EU and its Member States should i) continue to use responsible lending practices, including in blending and in export-credit operations, ii) push for the participation of non-Paris Club members in debt workout settlements, and iii) take national action to restrict litigation against developing countries by distressed-debt funds.

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[3] COM(2011) 637 final, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0637:FIN:EN:PDF

[4] http://www.imf.org/external/pp/longres.aspx?id=4611

3. FOSTERING INTERNATIONAL PRIVATE FLOWS FOR DEVELOPMENT

3.1. Trade as an Engine of Development

International trade is the biggest source of external finance for developing countries. However, emerging economies and more generally Middle Income Countries have been able to take better advantage of international trade than do Least Developed Countries (LDCs). Further efforts are needed to better integrate LDCs and other countries most in need in the Multilateral Trading System.

Overall, the EU is the biggest trade partner and the most open market for developing countries, accounting for 16% of their total trade. The EU works steadily to improve coherence and complementarity between its trade and development policies.[5] Furthermore, the recent Communication on "Trade, Growth and Development"[6] sets new orientations for the next decade on ways to improve the contribution of the EU's trade and investment policies to inclusive growth and sustainable development. Like the Agenda for Change, the new EU trade and development policy will be based on greater differentiation among developing countries, prioritising LDCs and other countries most in need.

Alongside the significant policy support, EU development assistance also reflects this commitment. The total Aid for Trade funds committed by the EU and Member States amounted to EUR 10.7 billion in 2010. The EU and its Member States exceeded already in 2008 the specific target to increase Trade-Related Assistance to EUR 2 billion per year by 2010. Africa remains the primary target of EU Aid for Trade (38%), but the share of LDCs decreased to 16% from 23% in 2009. This is partially due to cyclical and programming factors, but it also indicates the need to implement the orientations of the Communication on "Trade, Growth and Development". Concerning future financing commitments, The EU Aid for Trade Strategy makes a commitment to increase Aid for Trade in coherence with the gradual increase of overall EU aid.

3.2. The Development Impact of Remittances

Global remittance flows to developing countries were estimated at €267.5 billion in 2011 and are expected to grow at a rate of 7-8 per cent annually[7]. However remittances from the EU have kept momentum since 2008[8]. While these are private flows, the figures underline their potential for development impact; achieving the G8 target of reducing the cost of sending remittances to 5% would increase the funds reaching developing countries by around €11 billion[9].

At EU level, significant progress has been made in making remittance services cheaper, more transparent, more competitive and more reliable, through initiatives such as the transposition of the 2007 Payment Services Directive (PSD) into the national legislation of a majority of EU Member States, the setting up by several EU Member States of remittance price comparison websites and support to developing countries' capacities to maximise the development contribution of remittances. Like trade policy, this issue is analysed in greater

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5 See: EU 2011 Report on Policy Coherence for Development (PCD), SEC(2011) 1627 final.

6 COM(2012)22 final of 27 January 2012, http://ec.europa.eu/trade/wider-agenda/development/

7 Migration and Development Brief No 17, World Bank, Migration and Remittances unit, December 2011.

8 Eurostat Statistic Focus 4/2012.

9 'Innovation With Impact: Financing 21st Century Development', Report by Bill Gates to G20 leaders, Cannes Summit, November 2011.

detail in the EU PCD report. The EU has outlined the necessary actions in the Communication on ‘The global approach to migration and mobility’[10], as well as in the accompanying Staff Working Paper[11], the EU and its Member States need to implement the commitments confirmed in the 29 May 2012 Council Conclusions[12] to maximise the development impact of migration and mobility.

4. OFFICIAL FINANCING FOR GLOBAL GOALS

4.1. Scaling up Official Development Assistance

ODA is a key resource for development, especially for the poorest countries. Unfortunately, in 2011 the EU’s collective ODA decreased to €53.1 billion from €53.5 billion in 2010. This limited reduction, in a context of sharp budget cuts due to the ongoing economic crisis, brings the EU ODA level to 0.42 % of GNI, down from the 2010 outcome of 0.44 % of GNI. Nevertheless, the EU is by far the biggest global ODA donor, accounting for over half of the total ODA to developing countries.

The EU Foreign Affairs Council of 14 May 2012 adopted the ‘Annual Report 2012 to the European Council on EU Development Aid Targets’[13], expressing serious concern over the slow progress towards the ambitious EU target of 0.7 % ODA/GNI by 2015.

Reflecting the strong EU commitment to focus on the poorest, the EU and its Member States have also made specific commitments to increase aid to Africa and Least Developed Countries. Since committing in 2005 to direct 50 % of EU aid increases to Africa, the combined EU aid to Africa has risen by about EUR 6.2 billion at constant prices so that 28 % of total EU ODA growth between 2004 and 2011 went to Africa. While short of the target, most EU Member States are taking steps to increase the ODA targeted at Africa and stress the importance of Africa’s share in their overall ODA. In 2011, EU ODA to Africa stood at €25.3 billion, accounting for a significant 43 % of total EU ODA.

Also, in 2011 the EU fulfilled for the first time its commitment to collectively provide at least 0.15 % of GNI to LDCs. The LDCs’ share of EU ODA has increased over the years and reached 35 % in 2011; this is EUR 18.8 billion or 0.15 % of GNI.

4.2. Accounting for all ODA

With greater use of a differentiated approach to development and aiming to increase the impact of funding, donors are using more loans as a development tool, especially for more advanced developing countries. This calls for a clearer understanding of how the concessional character of loans is determined in accounting for ODA, to avoid artificially inflating or deflating ODA figures, and ensure comparable information on donors.

Action: To this end, the EU and its Member States should agree that the existing method for determining concessionality of loans and equity in ODA reporting needs to be clearly defined in the OECD DAC, ensuring equal treatment of all donors.

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10 COM(2011) 743.

11 SEC(2011) 1353.

12 9417/12

13 9372/12; http://register.consilium.europa.eu/pdf/en/12/st09/st09372.en12.pdf

4.3. Scaling up Funding for Tackling Climate Change and Preserving Biodiversity in the wider context of Sustainable Development

Sustainable development including social development, economic growth and environmental protection is a key global challenge. The EU is helping developing countries to devise an inclusive approach to addressing all of its elements, including decent work, labour standards and environmental protection through various specific actions as well as through mainstreaming, while promoting a unified approach in the provision of support. At the recent United Nations Conference on Sustainable Development in Rio, the EU renewed its commitment to support all aspects of sustainable development. On some areas, the EU has taken specific financial commitments.

As regards climate finance, the EU and its Member States are by far the largest contributor, accounting in 2010 for more than 70 % of both mitigation-related and adaptation-related ODA globally. The EU remains on track to achieve the goal of providing fast-start climate finance of EUR 7.2 billion over the period 2010-2012, having delivered another EUR 2.33 billion in 2011. The details of EU progress on the latter have already been presented in May[14]. The EU also reiterated the commitment for doing its fair share in the context of the longer term global financial pledge of USD 100 billion per annum by 2020, and confirmed the continued importance of transparent reporting on progress made.

Also, the EU has adopted the 'EU Biodiversity Strategy to 2020', which reconfirms the commitment to support developing countries in implementing international biodiversity agreements, including by substantially increasing resource mobilisation to this end. In 2010, EU collective biodiversity-related ODA stood at EUR 3 billion.

Addressing all these challenges means mobilising significant resources from all possible areas of financing for development. But it also means that financing for these policy areas cannot be seen separately from the domestic policy environment of partner countries, e.g. the fossil fuel subsidies in emerging and developing countries which amounted to €309 billion in 2010[15] and which more than offset the effects of financing provided to reduce global greenhouse gas emissions. This also shows that EU should continue to promote policies in both donor and partner countries that reinforce each other to leverage the best possible development results.

5. LEVERAGING DEVELOPMENT FINANCE AND SEEKING SYNERGIES

5.1. Innovative Financing Sources

'Innovative financing' is considered an important financing source for most global public goods, including addressing global development challenges. At the same time, given their innovative nature, it is impossible to establish a complete list of *sources* and *mechanisms* that fall under this term. Because of this, the estimated potential of innovative financing to mobilise new funds varies greatly.

[14] 10029/12, http://register.consilium.europa.eu/pdf/en/12/st10/st10029.en12.pdf

[15] e.g. OECD (2011), *Tackling Climate Change and Growing the Economy.* http://www.oecd.org/dataoecd/28/18/44287948.pdf

The Commission has proposed an EU-wide financial transaction tax, strongly supported by the European Parliament[16], which would contribute through the EU budget also to tackling global challenges. Although not explicitly directed to development financing, it would reduce the share of other resources in the EU budget, in the magnitude of EUR 54 billion by 2020[17], which could in turn make it easier for Member States to mobilise funding required for meeting aid targets and tackling other global challenges. Another potential source of increasing importance is the revenue from the Emissions Trading System that some Member States already partly direct towards supporting developing countries.

Action: The Council should adopt the proposed EU-level Financial Transaction Tax.

5.2. Innovative Financing Mechanisms and Engaging Private Sector

There is an increasing range of ways to collect and pool revenues, use traditional development finance and deliver aid. Engaging the private sector in development financing is another innovative way of mobilising new funds.

In many developing countries, the expansion of the private sector is a powerful engine of economic growth and the main source of job creation. Foreign investment also plays an important role, including through domestic firms' linkages to international markets and through investments. One of the main challenges for governments in developing countries is to ensure an environment that supports private sector development. This often requires far-reaching economic reforms aimed at improving the investment climate and facilitating access to finance. Accordingly, and as outlined in the EU Agenda for Change[18], the EU should continue to assist partner countries' efforts to improve their business environment with a view to fostering inclusive growth.

The EU promotes actively the Corporate Social Responsibility (CSR) principles including human and labour rights, decent work parameters, as well as attention to local environmental conditions. The recent Commission Communication on CSR[19] outlined this in detail and the Council took specific commitments in its Conclusions on "Reinforcing Industrial Policy in the EU"[20].

The EU should also use its grants more strategically and effectively for leveraging public and private sector resources. Half of the Member States are already actively engaged in several innovative mechanisms. The EU and Member States, together with European and International public financing institutions are actively collaborating though various regional blending mechanisms which are expected to be further scaled up in future in order to leverage grant resources. This includes the potential to make greater use of guarantee mechanisms, equity investments and other types of innovative financing. In this context, the EU is currently exploring with Member States and financing institutions, the establishment of an "EU Platform for External Cooperation and Development" to maximise the impact of resources

16 http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/375&format=HTML&aged=0&language=en&guiLanguage=en

17 http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/300&format=PDF&aged=0&language=EN&guiLanguage=fr

18 http://ec.europa.eu/europeaid/what/development-policies/documents/agenda_for_change_en.pdf

19 http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr/new-csr/act_en.pdf

20 http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/intm/126548.pdf

through enhanced cooperation, coherence, monitoring and development of new innovative financing mechanisms.

Action: The EU, Member States and public financing institutions should step up efforts for increased use of innovative financing mechanisms on a coherent, coordinated and strategic basis. The EU should leverage more private resources and capacities through blending mechanisms that can crowd-in additional private and public financing: i) create a private sector window within the regional blending mechanisms, ii) make greater use of risk-sharing mechanisms such as guarantees that can unlock investments and iii) promote investments through instruments that entail improved risk management and equity participation in structured funds.

5.3. Strengthening Synergies between various Financing Sources

The resources covered in the previous chapters are intrinsically linked to each other, as are also the global challenges these need to address. Ultimately, each country needs to find its individual balance between these priorities in domestic implementation for delivering the best compound return on all fronts. However, the tendency for different policy areas to 'compete' for resources contributes to aid fragmentation and less development effectiveness. This can be observed in the overlap of financing sources through which the various challenges can be met, with all parties vying for more domestic resources and international finance, increased private sector engagement and use of innovative mechanisms. Therefore, there is scope for finding synergies between all these policies.

In this light, the tendency to set boundaries between policy areas and instruments can prove counterproductive. While in theory locking in expenditure on specific policies, the artificial categories will restrict the policy space of countries to target resources according to what brings best results in the national context. While there are early signs of an emerging international consensus that a joined-up approach is needed to tackle global challenges, this will need further analytical work and a cross-cutting approach to avoid undermining policy goals.

Action: The EU and its Member States should support an integrated approach to development financing, including monitoring its various elements, possibly in the context of the discussions on a post-2015 development framework, and should establish a common EU position on this.

6. Making EU Actions more effective: Busan Implementation at Country Level

In responding to the outcomes of the Busan High Level Forum on Aid Effectiveness, the EU should focus on country-level implementation of aid and development effectiveness commitments, in particular through supporting partner country capacity and leadership to set priorities and achieve results. The EU has in place a broad spectrum of guidance for this purpose: the EU Common Position for Busan, the Operational Framework on Aid Effectiveness and the EU Code of Conduct on Complementarity and Division of Labour. These remain valid; however, some key issues should be prioritised for collective EU action at the country level in line with Busan outcomes and the Council Conclusions on the Agenda for Change.

6.1. Country-Level Results Frameworks

Focus on results was identified in Busan as a major priority. The Busan outcome document states that all development partners should rely to the maximum extent possible on country-led and country-level results frameworks as a common tool to monitor outputs and outcomes drawn from the development goals of partner countries.

Considerable work is still required in establishing and using country-level results frameworks. While acknowledging partner countries' lead, the EU should play an active role in this process in coordination with existing initiatives. EU collective action should follow the approach for mutual accountability frameworks as set out in the EU Operational Framework, namely EU Delegations initiating discussions to support existing frameworks and develop new ones together with Member States, partner countries and other stakeholders.

6.2. Mutual Accountability Frameworks

Country-level mutual accountability frameworks are key tools with which to foster the implementation of aid and development effectiveness commitments on the ground. These are also likely to be instrumental in any future monitoring within the Global Partnership for Effective Development Cooperation.

The full potential of mutual accountability frameworks is yet to be tapped, thus collective EU support to strengthen or establish these frameworks is timely. This support should be provided under partner country leadership and in coordination with other processes and actors, and giving consideration to the expected supporting role of UNDP country offices. The EU should place particular emphasis on how to address in these frameworks the partner countries' priorities in relation to Busan, including the use of country systems and capacity development.

6.3. Reduced Fragmentation

Development partners committed themselves in Busan to increased use of country-led coordination arrangements to reduce fragmentation. Collective EU action on the ground is of particular value as the Fast Track Initiative on Complementarity and Division of Labour has built EU experience in this area and should be pursued, preparing the ground for further joint programming.

Donor mapping is one of the activities that can enhance in-country division of labour. In line with Busan priorities, the EU and its Member States should expand country-level mapping to cover the support they give to climate action based on Fast Track Initiative methodology and building on the OECD Rio Marker system. It would complement the EU's and Member States' potential measures to support national strategies for climate action and promote the integration of climate risks into development strategies.

Action: Collective EU action to strengthen country-level implementation of aid and development effectiveness commitments based on the EU Operational Framework through i) supporting country-level results and mutual accountability frameworks, and ii) continued division of labour activities, including mapping of EU support for climate action at the country level, leading to conducive environments for joint programming.

7. CONCLUSIONS

The next three years will see important developments. The EU will need to deliver on its commitments and prepare a common and coherent approach also on the means for reaching any new goals. Even with the changing global context, the EU has to remain focused on the essential objective: providing the best support it can to developing countries in mobilising all available resources for development.