



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT**

**Accelerating progress towards attaining the Millennium Development Goals - Financing
for Development and Aid Effectiveness**

{SEC(2005) 453}

{SEC(2005) 454}

EXECUTIVE SUMMARY

The UN High Level Event (HLE), which will notably take stock of the progress achieved on the Millennium Declaration, including the Millennium Development Goals (MDGs), will include a distinctive meeting on Financing for Development (FfD) and will be prepared by the UN High Level Dialogue on FfD. The annual monitoring questionnaire submitted to Member States in October 2004 took these circumstances into account in the formulation of the specific questions.

Based on the replies by Member States (MS) the Commission: (1) provides an update on the state of implementation of the eight “Barcelona Commitments” which the EU made in the context of the Monterrey Conference on Financing (FfD) in 2002, (2) assesses which of them need to be renewed (Official Development Assistance (ODA), innovative sources of financing, debt relief) and where progress in the European Union or on the international arena justifies a review of commitments (coordination, Global Public Goods (GPG)), and (3) presents concrete proposals for new EU commitments.

The original commitments on ODA volume, coordination of policies and harmonisation of procedures, untying of aid, Trade-Related Assistance (TRA) and debt relief could be met in 2006, and it might therefore be timely to consider new concrete commitments for the time thereafter. The state of the art of work on GPG and Innovative Sources of Financing would justify consideration of more concrete commitments. The state of discussions on the reform of the International Finance System, however, makes it unlikely that the desired results will be achieved by 2006.

The Communication outlines a way towards a possible new interim target for increased ODA volumes in the EU by 2010 and towards the UN target for ODA of 0.7% Gross National Income (GNI) by 2015. It suggests new aid modalities as well as a line on innovative finance sources and proposes ways to address the remaining post-HIPC debt problems of low income countries. With regard to GPG it suggests redefining the EU commitment. On coordination and harmonisation the main challenge ahead lies in credible implementation of the recently agreed EU framework as well as of the results of the recent High Level Forum on aid effectiveness and concrete steps forward on complementarity in aid delivery. The commitment on reform of the International Finance System must be strengthened.

1. BACKGROUND: THE MONTERREY CONSENSUS, THE EU CONTRIBUTION AND THE WAY AHEAD

The Conference on Financing for Development in Monterrey addressed the two issues of the necessary “means” (i.e. financing) and the most effective “ways” (i.e. aid effectiveness) of achieving the internationally agreed development goals including the objectives of the Millennium Declaration. These are two mutually reinforcing objectives, and progress should be made on both. The EU contributed to the positive result of the Monterrey Conference, through the so-called “Barcelona commitments”¹ composed of:

¹ Council Conclusions of 14 March 2002 on the UN Conference on FfD (Monterrey), see Annex 1.

- *Commitments on ODA, volume and sources* – increased ODA volumes, innovative sources of financing, initiatives concerning GPG and debt relief for Heavily Indebted Poor Countries (HIPC);
- *Commitments on aid effectiveness* – closer coordination of policies and harmonisation of procedures, untying of aid, trade-related assistance (TRA), the reform of the International Financial System.

The Council mandated the Commission to monitor the implementation of the commitments. The 2003 report fed into the preparations for the first UN High Level Dialogue on FfD in October 2003². The 2004 report³ triggered the EU report “*Advancing coordination, harmonisation and alignment: The contribution of the EU*”, endorsed by the Council in November 2004⁴, which formed a substantial input to the High Level Forum II (HLF II) in Paris in March 2005.

Among the key challenges for the HLE, to which the EU is expected to make a substantial contribution, are: (i) a persistent financing gap, (ii) the effective use of ODA and (iii) the continuing unsustainable debt burden on many poor countries.

A detailed description of the state of progress in the implementation of the EU commitments is set out in a separate Staff Working Paper⁵.

² SEC(2003) 569, 15.5.2003.

³ COM(2004)150, 5.3.2004.

⁴ Council conclusions of the GAERC 22-23.11.2004; 14724/04 (Presse 325) p. 37, see Annex 2.

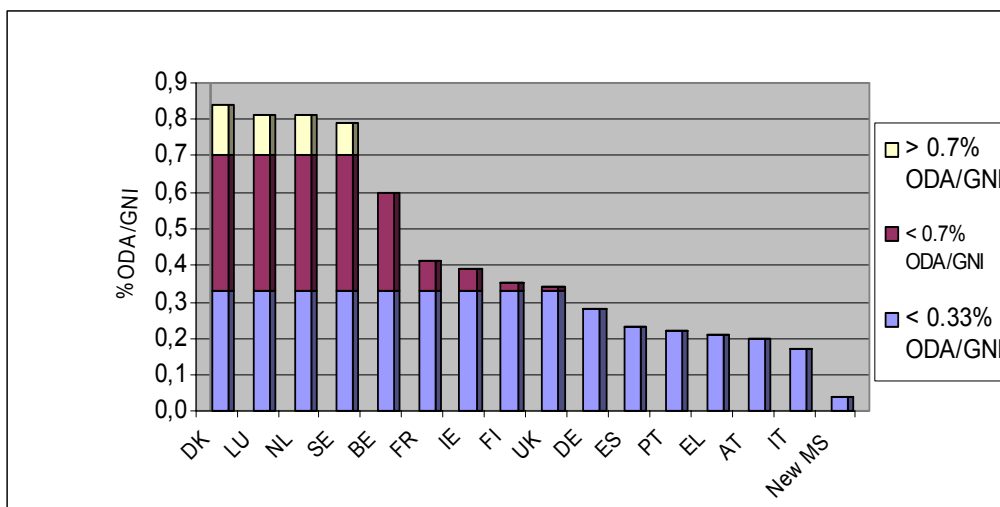
⁵ Staff Working Paper SEC(2005) 453: EU follow-up to the “Barcelona commitments” and operationalisation of the Monterrey Consensus.

2. THE COMMITMENT TO INCREASE FINANCIAL RESOURCES FOR ODA

2.1. EU performance in 2003

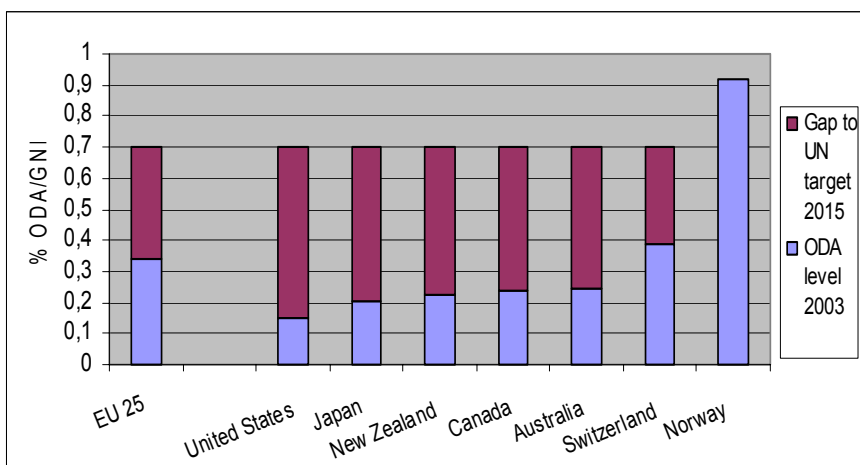
In terms of the ODA/GNI ratio the Barcelona commitment sets an individual baseline target of 0.33% for each MS that contributes to achieving the collective EU target of 0.39% by 2006. In 2003 the EU reached an average of 0.34% of ODA/GNI. This is above the average of OECD/DAC countries (except for Norway and Switzerland). Ten MS have either achieved or pledged to achieve the commitment of 0.7% ODA/GNI. An ODA decrease in Austria, Denmark, Ireland, Spain, Sweden and Italy recorded in 2003 is partly a consequence of exceptional ODA increases in 2002 due to special debt relief efforts.

Diagram 1: EU ODA levels by Member States in 2003



Data source: OECD/DAC Annual report 2004, statistical annexes.

Diagram 2: ODA/GNI contributions in 2003: The EU compared to other DAC Members

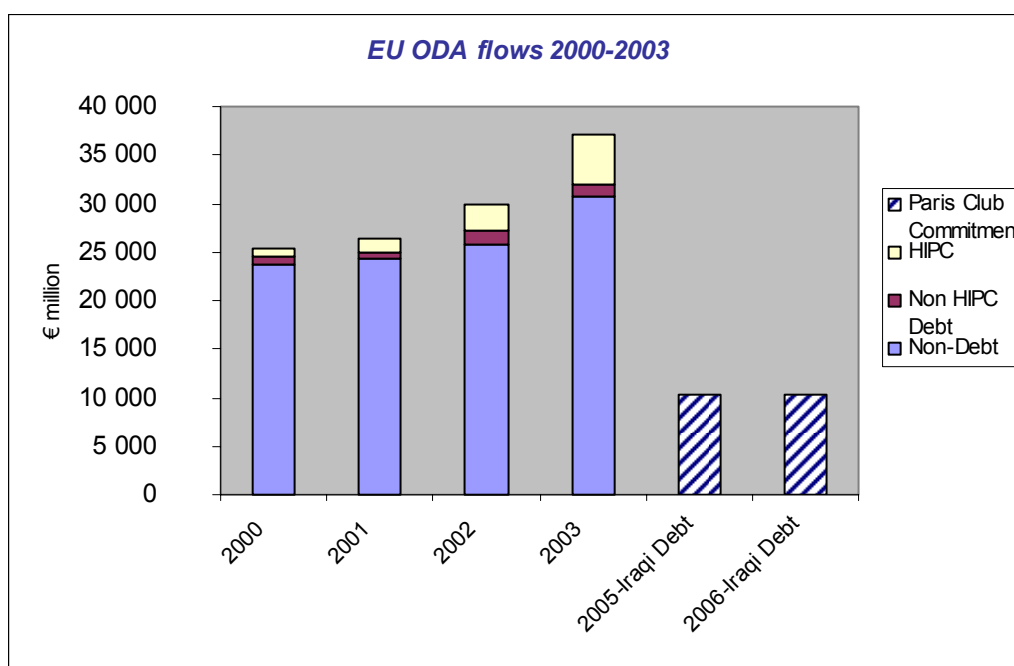


Data source: OECD/DAC Annual report 2004, statistical annexes.

In terms of actual volume, ODA rose in 2003 in 12 MS compared to 2002⁶. EU-25 ODA flows increased from €28.4 bn in 2002 to €33 bn in 2003, representing an additional €4.6 bn p.a.. The new MS increased their collective contribution by 53% in real terms.

While ODA flows have grown, a sizeable proportion of the increase is due to debt relief operations. It is not in keeping with the spirit of the Monterrey consensus, which indicated that the HIPC initiative “should be fully financed through additional resources”. In this respect, the effect and impact on ODA flows of the debt relief efforts, such as the one for Iraq, will have to be scrutinized. In addition, it is important that debates on the definition of ODA don’t undermine the credibility and measurability of the donors’ commitment made in Monterrey.

Diagram 3: EU ODA flows and debt relief 2000-2003



Data source: OECD/DAC Annual report 2004, statistical annexes.

2.2. ODA perspective for 2006

If commitments by MS are confirmed over time, the EU would collectively reach an ODA level of 0.42% of GNI in 2006 – representing a potential allocation of €46.5 bn p.a. In this context, the low level of Italian ODA remains of particular concern.

⁶ Belgium (by 62,9%), France (by 30,5%), Sweden (by 27,6%), Luxemburg (by 26,3%), United Kingdom (by 23,4%), Ireland (by 18,3%), Germany (by 18,1%), Greece (by 14,4%), Spain (by 13,7%), Finland (by 11,7%), the Netherlands (by 9,9%) and Portugal (by 5,7%).

Table 1: EU ODA levels 2003-2006

	2003		2006	
	ODA € ml	GNI %	ODA € ml	GNI %
Austria	447	0,2	814	0,33
Belgium	1640	0,6	1568	0,5
Cyprus	2	0,02	3	0,02
Czech Republik	80	0,11	125	0,133
Denmark	1547	0,84	1716	0,82
Estonia	1	0,013	2	0,02
Finland	494	0,35	672	0,42
France	6420	0,41	8284	0,47
Germany	6005	0,28	7565	0,33
Greece	320	0,21	616	0,33
Hungary	19	0,03	27	0,03
Ireland	446	0,39	856	0,61
Italy	2153	0,17	4795	0,33
Latvia	1	0,008	5	0,037
Lithuania	2	0,01	14	0,07
Luxembourg	172	0,81	223	0,9
Malta	3	0,07	9	0,18
The Netherlands	3524	0,8	3947	0,8
Poland	24	0,01	227	0,1
Portugal	283	0,22	479	0,33
Slovak Republic	13	0,05	33	0,092
Slovenia	20	0,1	29	0,1
Spain	1736	0,23	3288	0,37
Sweden	2124	0,79	2819	1
UK	5560	0,34	8146	0,42
EU 15 TOTAL	32871	0,35	45788	0,43
EU 10 Total	165	0,04	474	0,09
EU 25 TOTAL	33036	0,34	46262	0,42

Data sources: OECD/DAC Annual report 2004, statistical annexes and replies of EU Member States to the Monterrey questionnaire

2.3. A new interim target for 2010

The European Council of December 2004 confirmed the EU's commitment to the MDGs and mandated the Commission to present to the Council "*concrete proposals on setting new and adequate ODA targets for the period 2009-2010, while taking into account the position of the new Member States*".

The Commission suggests establishing two intertwined targets to be reached by 2010:

- (1) an individual threshold for MS, differentiating between those who were already members of the EU in 2002 (Barcelona commitments-EU15) and those who joined later (EU10);
- (2) a collective average for all Member States (EU25).

These targets have to be sufficiently ambitious in order to credibly ensure that it is possible to **reach 0.7% by 2015**. In line with the Council request to set a “*new and adequate target*” this entails to **go half the way by 2010** to bridge the gap. Based on the approach applied for the Barcelona commitments in 2002 the Commission proposes

- (1) for each of the Member States which participated in the Barcelona Commitments (EU15) that are still below the following baseline, to increase ODA to the new **individual baseline of (0.51) %** of ODA/GNI.
- (2) For the MS having joined after 2002 (**EU10**) to reach an **individual baseline of (0.17)%** ODA/GNI in 2010, thereby reaching the midpoint towards the “Barcelona acquis” of 0.33% in 2015..

The figure of 0.51 % in 2010 represents the midpoint between 0.33% in 2006 and 0.7% in 2015. The proposal will ensure a fair burden sharing between the MS and result in a **collective average of (0.56) %** (EU 25), triggering an estimated additional €20 billion by 2010.

Table 2: Proposal for new EU ODA targets 2006-2010

	2006		2010		GAP 2010-2015	
	ODA m euro	%GNI	ODA m euro	%GNI	ODA m euro	%GNI
Austria	813,50544	0,33	1360,8723	0,51	538,2346	0,19
Belgium	1567,99	0,5	2376,1399	0,7	0	0
Cyprus	2,7733008	0,02	25,516235	0,17	25,495202	0,16
Czech Republik	124,92917	0,133	172,84699	0,17	0	0
Denmark	1716,3469	0,82	1789,8597	0,79	0	0
Estonia	1,9631515	0,02	18,062316	0,17	18,047427	0,16
Finland	671,90088	0,42	1212,1452	0,7	0	0
France	8283,8971	0,47	12210,052	0,64	1215,2331	0,06
Germany	7565,3309	0,33	12655,661	0,51	5005,4034	0,19
Greece	616,45089	0,33	1031,2297	0,51	407,85861	0,19
Hungary	26,487151	0,03	162,46642	0,17	162,3325	0,16
Ireland	855,82207	0,61	1063,0468	0,7	0	0
Italy	4794,8617	0,33	8021,083	0,51	3172,3949	0,19
Latvia	5,1893117	0,037	25,808196	0,17	25,786922	0,16
Lithuania	14,414532	0,07	40,121366	0,18	35,494844	0,15
Luxembourg	223,2018	0,9	241,60081	0,9	0	0
Malta	8,7966102	0,18	9,5217337	0,18	8,4237524	0,15
The Netherlands	3946,952	0,8	4272,3078	0,8	0	0
Poland	227,12154	0,1	417,93422	0,17	417,58972	0,16
Portugal	479,03064	0,33	801,34626	0,51	316,9381	0,19
Slovak Republic	33,185133	0,092	66,375124	0,17	66,320412	0,16
Slovenia	29,316122	0,1	53,945612	0,17	53,901145	0,16
Spain	3288,2821	0,37	5194,7158	0,54	1634,0255	0,16
Sweden	2818,7209	1	3051,0742	1	0	0
UK	8145,7779	0,42	10706,663	0,51	4234,5608	0,19
EU 15 TOTAL	45788,071	0,43%	65987,798	0,58%	24053,57	0,12%
EU 10 Total	474,17602	0,09%	992,59821	0,17%	1128,8	0,16%
EU 25 TOTAL	46262,247	0,42%	66980,396	0,56%	25182	0,14%

In the light of the above, the Commission asks the Council to:

- **continue efforts** to implement the Barcelona ODA commitment; call on those of the EU-15 who have not yet done so to establish, by 2006, a firm timetable to achieve the UN target of 0.7% ODA/GNI;
- **call on Member States** having joined the Union after the Barcelona commitments (March 2002) (EU10) to establish a firm timetable to reach the “Barcelona *acquis*” by 2015;
- ensure that further developments in **debt relief**, on the one hand, and changes in the **definition of ODA**, on the other hand, do not harm the credibility of the commitments made in Monterrey;
- agree to the proposed new individual and collective intermediate targets for 2010.

3. AID EFFECTIVENESS: COORDINATION, COMPLEMENTARITY

Actions to improve the effectiveness of ODA would reduce transaction costs, ensure better value for money and allow longer-term commitments, all of which translate into the availability of more resources for action in recipient countries. A majority of MS have reformed the way they prioritise, organise and implement their external assistance. The Commission’s own reform has begun to bear fruit and will continue, inter alia through the simplification of external assistance instruments, currently discussed in the context of the Financial Perspectives 2007–2013.

The international process on coordination has received a strong impetus through the second High Level Forum on Aid Effectiveness (HLF II) of Paris in March 2005, which provides a comprehensive agenda for immediate implementation: International donors and aid recipient countries agreed on commitments related to ownership, alignment, harmonisation, managing for results and mutual accountability⁷. In view of the HLF II the EU adopted as its contribution to the Forum a comprehensive framework with time-bound objectives⁸. It is based on the Council Conclusions on harmonisation in November 2004. Moreover, the EU committed itself in Paris to additional concrete targets, in particular to: (1) provide all capacity building assistance through coordinated programmes with an increasing use of multi-donors arrangements, (2) to channel 50% of government of government assistance through country systems, (3) avoid the establishment of new project implementation units, (4) double the percentage of assistance provided through budget support or sector wide arrangements and (5) reduce the number of un-coordinated missions by 50%. These commitments have to be implemented gradually by the year 2010.

Nevertheless progress is still not fast enough and discrepancies between political commitments and concrete implementation continue. In many politically sensitive areas where vital interests are at stake (i.e. immigration, research) the EU acts in a much more coordinated way in its approach than in development assistance. This is a paradox in an area

⁷ Paris Declaration on Aid Effectiveness, High Level Forum Paris 28.2.-2.3.2005.

⁸ See Annex 2. These conclusions are based on the recommendations of the EU Ad Hoc Working Party on harmonisation. They are described at length in the Staff Working Paper.

where the EU provides the biggest share of ODA in the world (55%) and where calls for solidarity and collective response are repeatedly made.

Even in difficult, still largely intergovernmental fields, like foreign and security policy, the EU has been able to adopt the basis for common actions (European Security Strategy). It is hard to understand that in the context described above, a policy area like development, governed by precise rules of the Treaty (Nice or Constitutional Treaty), is not further advanced. In order to enhance, implement and monitor EU coordination and complementarity the EU should seek to agree on a true European Development Strategy or a framework of guiding principles and rules to make its huge amount of aid more effective and genuinely “European”. Several models of flexible frameworks exist and could be easily adapted. We share common objectives (MDGs), and have agreed on the means and some benchmarks. The EU needs to formalise such a framework and its operational modalities. Where the EU has an added value as a collective actor, Community aid should – as in other policy areas – play a catalytic role through enhanced operational modalities such as co-financing and institutional cooperation. The EU Donor Atlas identified areas of fragmentation, gaps and duplication among donors. A qualitative jump is necessary in the implementation of the concept of division of labour which needs to be addressed through enhanced operational complementarity. EU joint multi-annual programming, as mentioned in the Council Conclusions (ADWPH), will help such a division of labour at country level.

It is essential that future efforts to enhance coordination and complementarity also cover the contribution by the private sector as well as civil society actors.

In the light of the above, the Commission invites the Council to:

- Closely monitor the implementation of the recommendations of the Council Conclusions of November 2004.
- Launch a discussion on the establishment of an EU voluntary framework for development assistance based on an open method of coordination allowing a combination of Community competence and national undertakings.
- Consider a regular report on the State of the Union on aid effectiveness prepared by the Commission together with the Member States.
- Launch an operational debate on complementarity, in particular on division of labour at country level, in the context of joint multi-annual programming documents.

4. UNTYING AID

As agreed in Barcelona, the European Union has made significant progress to ensure “better value for money” from its ODA. The MS have untied their aid to LDCs, as mandated by the DAC Recommendation. Moreover, a majority of them are progressing towards further untying. Proposals for untying EC aid are currently in the legislative process. The EU is also pursuing concurrent changes to Annex IV of the Cotonou Agreement.

The Commission notes that EC Single Market and competition rules apply to the procurement of Member States’ development assistance and it will actively ensure the functioning of the

Single Market. In addition, two studies commissioned by the OECD/DAC and the Commission have highlighted the added benefit and positive impact of further untying.

In the light of the above, the Commission invites the Council to:

- Rapidly complete its work on the Commission's **proposal for a Regulation** on untying.
- Support the ongoing debates at international level on **further untying** aid beyond the DAC Recommendations, with a specific emphasis on food aid, food aid transport and access by recipient countries to donors' aid.

5. TRADE-RELATED ASSISTANCE (TRA)

The EU is the largest contributor to TRA initiatives worldwide⁹, providing nearly 50% or €1 billion p.a., including to key multi-donor programmes such as the Integrated Framework for Least Developed Countries (LDC) and the Doha Global Trust Fund. In quantitative terms the EU is thus on track with the delivery of its 2002 commitment.

The challenge consists in further improving the quality and effectiveness of TRA and responding to new needs. In this context, the European Commission and some MS evaluated their respective TRA activities in 2004¹⁰. Key findings include that TRA: (1) resulted in improved knowledge of trade-related issues in partner countries and contributed to increased export performance and productivity of local enterprises; (2) needs to be based upon comprehensive needs assessments, used by recipient governments and all donors; (3) should be more flexible to adapt to rapidly changing situations.

Coordination of TRA planning and its effective delivery in the EU and the wider donor community should be a focus for the future. The work in the EU Informal Trade and Development Expert Group and the constructive contribution to the OECD/DAC work on monitoring are steps in this direction. A joint evaluation is planned for 2005 to look at EU coordination in the field of TRA.

There is growing consensus that many developing countries will face significant adjustment costs to meet the challenge of integration into the multilateral trading system and to reap the growth benefits of trade liberalisation, achieved through the WTO Doha Development Agenda negotiations. Trade-based economic adjustment and growth will only be achieved through substantially increased funding for TRA and supply side development. The Commission will seek to establish a special facility, which could draw on innovative sources of finance, notably to help achieve the objectives of connecting Africa in infrastructure and trade.

In the light of the above, the EU invites the Council to agree to:

⁹ As reported in the Doha Development Agenda Trade Capacity Building Database (TCBDB). The EU provides around 50% of worldwide TRA. The lion's share comes from the EC, which has allocated an average of €700 million/year to TRA since 2001. Among the Member States, the picture is mixed: some have scaled up their support for TRA.

¹⁰ UK (DFID evaluation of TRA), the NL and D.

- **Improve EU co-ordination:** (1) at Headquarters and field level, involving the beneficiary country/region and other key donors, and (2) regarding the EU input into wider international initiatives, such as the Integrated Framework for LDC. Existing coordination channels, e.g. the EU Trade and Development Expert Group, can be used. This includes **intensified information exchange** for TRA planning and delivery and the exchange of “best practices”.
- Reinforce the **dialogue with recipient countries** to ensure that they integrate trade policies into their national poverty reduction and development strategies.
- Improve TRA programming by carrying out **systematic trade needs assessments**, where appropriate and agreed to by partner countries;
- Ensure more flexible TRA programmes that can adapt to changing situations (for example to deal with sanitary/phyto-sanitary issues) and that involve **new delivery methods**, e.g. budget and sector support to: (1) facilitate adjustment - including the social dimension - to trade policy reforms (2) to strengthen the productive sector, (3) support social safety mechanisms to protect the poor and to (4) promote that trade and environment policy frameworks are mutually supportive and directed at sustainable development.
- Provide additional support for trade adjustment and integration in view of the expected high trade integration costs faced by developing countries.
- Examine the scope for **funding horizontal TRA initiatives** to provide more effective support across geographic regions or involving multilateral agencies.

6. GLOBAL PUBLIC GOODS

In 2003 France and Sweden established an international **Task Force (TF) on Global Public Goods**. Interested stakeholders have also been involved through the **Group of Friends of the Task Force**. From the Monterrey questionnaire it appears that ten EU Member States and the Commission are actively involved in the debate. The Final Report should include a time-bound and fully-costed Action Plan to enhance the provision of the six GPGs.

There seems to be an emerging consensus among Member States: (1) regarding the **definition of International Public Goods (IPG)** and the relevance of the selected six priority IPGs for enhanced action: trade, knowledge, peace and security, financial stability, global commons and eradication of communicable diseases; (2) concerning readiness to examine the Action Plan with a view to establishing an EU common platform for the provision and financing of IPGs, and (3) on the principle that IPGs should only be financed from existing ODA if their provision is linked to the Millennium Development Goals, the three pillars of sustainable development and other agreed development objectives.

In the light of the above, the Commission invites the Council to:

- Examine the forthcoming Task Force action plan on the basis of a Commission proposal for a common EU platform for the provision and financing of IPGs;

- Agree which IPGs fall outside the scope of development and should therefore be financed from non-ODA financing sources in their national budgets;
- Update the Barcelona Commitment as follows: to further work towards further collective multilateral action to enhance the provision of priority International Public Goods, starting with the establishment of an Action Plan at EU level, by 2006.

7. INNOVATIVE SOURCES OF FINANCING AND NEW DELIVERY MECHANISMS

The European Council of December 2004 agreed to “*explore innovative ways of financing*” and asked the Commission to submit relevant proposals with a view to the HLE.

Markedly greater aid is needed if developing countries are to reach the MDGs. In addition to new and adequate ODA targets for 2010, which must remain the EU’s first priority, the EU needs to define its position in the international debate on innovative sources. However, this must not delay action on increasing traditional sources of finance.

The objective of mobilising additional and more stable sources of finance must guide the discussion on innovative finance sources and aid modalities and should, in the medium term, lead to the provision of predictable funding – something akin to “own resources” for development.

Several Member States have been involved in exploring various types of new innovative finance mechanisms, of which the most prominent proposals are:

- the UK proposal to “**front-load**” **pledged aid increases** through an “**International Finance Facility**” (the IFF);
- **a range of proposals for international taxation** contained in the “Landau Report” and the work of the “Lula Group” comprising the Presidents of Brazil, Chile and France and the Prime Minister of Spain; and
- **voluntary options**, such as a **global lottery** or **charitable donations**.

All these proposals are worthy of attention but need to be checked against a set of criteria to determine the most promising options. Such criteria could include: How much would each proposal raise? How far would the funds be additional? How stable and predictable would they be? What are the competitiveness/sectoral impacts? What are the drawbacks, e.g. launch and administration costs, etc.? Which proposals can go forward fastest? Is (almost) universal support required or can proposals be implemented at regional, i.e. EU, level?¹¹

The IFF is designed as a temporary facility to frontload the commitments made in Monterrey, by issuing bonds in international capital markets, backed by binding commitments of donors to provide regular payments to the facility. It is not designed to provide additional resources on top of those already committed in Monterrey in 2002, but could help to fill the financing

¹¹ The Commission Staff Working Paper ‘Innovative sources of financing for development – a review of options’ examines the most important questions - SEC(2005) 467.

gap up to 2015 identified if the MDG are to be met. The European Commission believes that the IFF proposal merits careful study, though it raises some concerns and many details still have to be clarified, notably in terms of governance issues. While the idea of frontloading is tempting as it would raise additional resources immediately, the absorption capacity of developing countries would need to be enhanced in such a scenario. There might also be inter-generational implications in donor and recipient countries. The facility's costs would ultimately be borne by tomorrow's taxpayers, though the proponents claim that they are designed to be fit within the increased aid budgets that would be delivered in keeping with the pledges made at and since Monterrey. Moreover, after 2015 IFF donors' aid budgets would be partially used to reimburse IFF bondholders, with a potential risk for reduced ODA volumes available for developing countries. It is also not yet clear what accounting method would be used for donors' contributions, but for EU MS at least it is important to ensure that it does not impair fiscal transparency.

Several proposals for genuinely additional resources have been put forward in the course of recent discussions:

- Environmental/energy/transport-related taxes, like taxes on maritime transport, aviation, or a CO₂ tax/charge;
- Taxes on currency of financial transactions, like the Tobin tax;
- Health-related food taxes, like a tax on the sugar content of food;
- Taxes on the trade of arms;
- Taxes on the profits of large multinational companies.

Charitable activities and **corporate social responsibility initiatives** also merit attention. In addition to expressing, in a unique way, solidarity between people, these undertakings generate substantial amounts of money. The Commission believes that here, too, there is wide scope for innovation: much will need to come from the voluntary sector itself, for example using internet technology to enhance solidarity, but the Commission and Member States' Governments could consider helping through **tax incentives** for charitable donations, **twinning**, or by supporting the organisation of voluntary sources such as a **global lottery**.

Whatever options are finally implemented, whether from traditional or innovative sources, increased ODA flows are required. In order to ensure that these increased resources support developing countries' efforts to reach the MDG in the most effective way, **new aid modalities**, more predictable and less volatile, have to be designed. Current aid modalities do not provide the flexibility and predictability of aid flows that partner countries need to embark upon the medium-term investments needed to accelerate progress towards the MDG.

Each existing financing instrument has merits: projects can involve non-government actors, and on a larger scale budget support provides flexible funding aligned with national priorities. But none of them provides the ideal combination of medium-term predictability and flexibility to finance recurrent costs. Debt relief, though it meets these criteria, can produce perverse resource allocations. Therefore, new modalities are needed to support the necessary reforms for achieving the MDG. Highly aid dependent countries should be eligible for such new modalities: They should have shown their commitment to poverty reduction through the

implementation of a poverty reduction strategy and a credible results monitoring system . They should have the necessary economic stability and have demonstrated progress in public finance and governance.

Several mechanisms could be envisaged to ensure sufficient predictability while allowing donors to further adapt the level of their commitments on a performance basis: support guaranteed for three to five years, with a mid-term review defining the level of support for the next period; contracts over a ten-year period ensuring a minimum level of aid; three-year rolling commitments, etc. Violations of the "essential elements" under the terms of the partnership and cooperation agreements (*e.g.* violation of human rights) would lead to suspension of programmes.

These proposals should be discussed with partner countries at technical and political level. Sufficiently flexible and stable sources of finance need to be available to allow these innovative modalities to be implemented.

For countries facing external shocks, mechanisms of temporary debt relief should be further considered.

In the light of the above, the Commission invites the Council to agree to:

- accelerate work on the most promising options for innovative additional sources of finance;
- explore the scope for a **European initiative** to develop new, more predictable and less volatile aid modalities;
- study in depth innovative proposals to support private (corporate and charitable) initiatives.

8. REFORM OF THE INTERNATIONAL FINANCIAL SYSTEM

Effective monitoring of progress on this specific "Barcelona EU commitment" is difficult due to the general and complex nature of the undertaking, which requires long-term efforts to achieve progress. Developing a joint EU position, however, appears to be crucial to move towards honouring the Monterrey commitment on increased ownership by developing countries of their own future. EU Member States have expressed general satisfaction with the improved informal EU coordination between the EU Executive Directors of the IMF and the World Bank in Washington over the past few years - in the form of regular coordination meetings with which the Commission is associated. Moreover, the Economic and Financial Committee (EFC) has established a special sub-committee (SCIMF) to coordinate the EU position on IMF and related issues. This kind of EU collaboration should also be extended to the Regional Development Banks, where collective EU shareholding is significant.

However, more needs to be done. Several Member States expressed the wish to go further (*e.g.* improved information sharing, more harmonised approach).

In the light of the above, the Commission invites the Council to:

- agree to present as often as possible a **single European position in the international financial institutions (IFIs)**, to increase the visibility and influence (or voice) of the European Union in the IFIs;
- develop a joint **EU position on enhancing the voice** of developing and transition countries in international economic decision-making.

9. DEBT RELIEF

The EU is well on track in its support to the implementation of the extended HIPC initiative, and is fully delivering on this commitment. The new Member States are making the necessary contribution to HIPC as creditors, and some contributed to the HIPC Trust Fund. Most of the Member States are committed to go beyond the requirements of the HIPC scheme, by providing 100% debt relief on their pre-cut-off-date claims.

However, major concerns regarding the debt situation of poor countries remain and require further reflection¹² and action. In the **short term the overall funding of the HIPC initiative** is not fully secured as long as non-Paris Club creditors do not deliver their part of debt relief. A consensus is emerging **that the HIPC initiative will not suffice to ensure sustainable debt levels for poor countries in the long run** despite several extensions. G7 members have agreed on the principle of possibly full cancellation of multilateral debt¹³.

Efforts must therefore now concentrate on developing forward-looking strategies to tackle the issues at stake:

- The HIPC debt cancellation, although criticised, has been the most innovative approach in terms of aid transfer and transaction costs. However, financing needs go far beyond debt cancellation. Moreover, debt cancellation is a bad instrument in terms of aid allocation criteria, because the most indebted countries are neither the poorest, nor the best governed nor the most needy.
- Several **countries**, mostly **in post-conflict situations**, may still remain excluded from the HIPC initiative. Most Member States agree that this is a concern, but have no coherent view on possible solutions.
- Detailed analysis reveals that **some countries, even after their graduation from HIPC, will remain in or return to debt distress situations**. Most Member States agree or are not opposed to providing additional debt relief, but have diverging views on delivery arrangements.
- There is broad agreement in the EU that the forward-looking, sound debt sustainability analysis framework (DSA) developed by the IMF/WB for low-income countries, and its strict application, are crucial to tackle the aforementioned problems.

¹² See the EC-funded study “Beyond the HIPC Initiative” of March 2004:

http://www.europa.eu.int/comm/development/body/theme/hipc/docs/Beyond_HIPC_en.pdf#zoom=100.

¹³ G7 Finance Ministers Conclusions on Development, London, February 5, 2005.

- The DSA framework also emphasises the close relation between debt sustainability and vulnerability to external shocks, and the Commission is actively investigating instruments to assist countries hit by exogenous shocks.

In the light of the above, the Commission invites the Council to:

- support – beyond the implementation of the extended HIPC initiative – the creation and implementation of **alternative, tailor-made options** for those post-conflict countries with sizeable external arrears which will not have been able to benefit from the HIPC initiative, **so that they can better tackle the problem of having fragile institutions and most of the debt stock in arrears;**
- explore the possibility of using a temporary debt service relief facility, among other instruments, to alleviate the effects of **exogenous shocks** on debt distressed countries.

10. CONCLUSIONS

The EU is well on track to deliver on most of the “Barcelona commitments”. The UN HLE in September 2005 will focus on how to accelerate progress towards attaining the MDGs, especially in Africa. This challenges the enlarged EU to again demonstrate its commitment to addressing the FfD challenge through reinforced EU commitments. With the proposals included in this document the Commission intends to initiate a discussion with a view to establishing a new set of commitments and to reach an agreement on “Barcelona II”-type commitments. Whereas this Communication focuses on the tools for improved FfD, the Communication on Policy Coherence¹⁴ proposes other policy measures that could be undertaken to support the achievement of the MDGs.

¹⁴ COM(2005) 134.

Annex 1

Summary March 14, 2002: Council Conclusions on the International Conference on Financing for Development (Monterrey, Mexico, 18-22 March 2002)

The Council of the European Union:

“1. Considering that the International Conference on Financing for Development represents an historic opportunity to make progress towards the achievement of the Millennium Development Goals for poverty reduction and the other internationally agreed development targets in a holistic manner.

2. Recalling the need for all international partners to reach the UN goal of 0.7% ODA/GNI and the European Council Presidency Conclusions in Gothenburg and Laeken, and recognizing that mobilizing international private and public resources for sustainable development is essential, that resources would need to be increased in order to reach the Millennium Development Goals, including according to World Bank estimates a doubling of ODA;

3. Stressing that the Conference should be based on a spirit of strengthened partnership in which developing countries take primary responsibility for their own development, ensuring democracy, human rights and the rule of law, while developed countries actively support them, thus contributing to the "global deal" that will be discussed at the Johannesburg Summit

4. Recognizing that the issue of aid effectiveness both by donors and recipients must be adequately addressed to ensure that increased ODA flows have a positive impact on development, and resources go effectively and efficiently to fighting poverty and reducing inequality.

5. Stressing that developing countries have primary responsibility to create a sound macroeconomic environment, an appropriate framework for investments and guarantee that funds received are properly and effectively managed, engaging themselves to ensure good governance, achieve high standards of transparency and eliminate corruption.

6. Recalling the importance to development financing of the Doha Development Agenda, which should address the specific concerns and priorities of developing countries, allowing them to realize the full benefits of participation in the world economy.

7. And thus, in order to achieve a successful outcome of the Conference, the Council stresses the value of the Monterrey Consensus, and affirms its willingness to make **the following commitments**;

a) 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 increasing their ODA volume in the next four years within their respective budget allocation processes, whilst the other Member States renew their efforts to remain 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.

b) To take concrete steps on coordination of policies and harmonization procedures before 2004, both at EC and Member States level, in line with internationally agreed best practices

including by implementing recommendations from the OECD Development Assistance Committee Task Force on donor practice.

c) To implement the DAC recommendation on untying of aid to Least Developed Countries and continue discussions in view of further untying. The EU will also consider steps towards further untying of Community aid while maintaining the existing system of price preferences of the EU-ACP framework.

d) To increase assistance for long-term trade-related capacity building, productive capacity and measures addressing supply-side constraints in developing countries, as well as to provide immediate support for trade-related technical assistance in order to improve the negotiating capacity of developing countries in trade negotiations, including by commitments made at the WTO pledging Conference in Geneva on 11 March 2002.

e) To further work towards a participatory process at the global level, including the proposal of setting up a task force open to all actors on a temporary basis, designed to lead to the identification of relevant Global Public Goods.

f) To further explore innovative sources of financing and taking into account the conclusions of the Commission Globalization Report.

g) To influence the reform of the International Financial System by combating abuses of financial globalization, strengthening the voice of developing countries in international economic decision-making, and, while respecting their respective roles, enhancing the coherence between the UN, International Financial Institutions and WTO.

h) To pursue its efforts to restore debt sustainability in the context of the enhanced HIPC initiative, so that developing countries, and especially the poorest ones, can pursue growth and development unconstrained by unsustainable debt dynamics."

Website link: http://europa-eu-un.org/articles/en/article_1222_en.htm

Annex 2

Extract of the Conclusions of the General Affairs and External Relations Council of 22-23 November 2004 on the report of the Ad Hoc Working Party on Harmonisation:

RECALLING:

The Commission Communication of 5 March 2004 on "Translating the Monterrey Consensus into practice: the contribution by the European Union"¹⁵;

Its Conclusions of 27 April 2004¹⁶, which called for the establishment of an Ad-Hoc Working Party of the Council consisting of experts on Harmonisation (AHWPH), in order to examine in detail the Commission recommendations contained in the Commission Communication and other relevant proposals with a view to translating the Barcelona Commitment II into practice;

The decision adopted by the COREPER establishing the AHWPH and setting up its mandate¹⁷;

That the Working Party was invited to report back to Council no later than November 2004, with a view to adoption by the Council of an EU Action Plan for Coordination and Harmonisation for submission to the Second High Level Forum on Harmonisation and Alignment for Aid Effectiveness to be held in Paris in 2005;

THE COUNCIL,

NOTING that the COREPER, on 18 November 2004 agreed on the Report presented by the AHWPH;

ENDORSES the report of the Ad-Hoc Working Party on Harmonisation entitled "Advancing Coordination, Harmonisation and Alignment: the contribution of the European Union";

INVITES the relevant Council bodies to continue the work for preparing the participation of the EU to the Second High Level Forum on Harmonisation and Alignment for Aid Effectiveness to be held in Paris in 2005;

REAFFIRMS its intention to monitor regularly the further progress made with the view to translating the Barcelona Commitment II into practice.

¹⁵ Doc. 7108/04 - COM(2004) 150.

¹⁶ Doc. 8973/04.

¹⁷ Doc. 9188/04.