

## A European Development Fund for the MDGs

by Jeffrey Sachs, John McArthur and Guido Schmidt-Traub

With the European Council's recent announcement that all EU-15 Member States' Official Development Assistance (ODA) will reach the target of 0.7% of gross national income by 2015, Europe has clearly established its global leadership in donor financing for the Millennium Development Goals (MDGs). The central issue for European ODA policy is now, therefore, how to use these new resources most effectively. Anchored in the new timetables to reach the 0.7% goal, a reformed and expanded European Development Fund (EDF) is needed to support the achievement of the MDGs, with a particular focus on sub-Saharan Africa.

### The case for more aid

The recent major reports by the UN Millennium Project, the Commission for Africa and the UN Secretary-General highlight the feasibility of the MDGs, but only if development assistance is rapidly increased. More specifically, OECD donor countries need to follow through on their longstanding commitment to the target of spending 0.7% of GNI on ODA by setting timetables to reach this target by 2015. Since sub-Saharan Africa is the poorest continent and is also furthest away from achieving the Goals, the bulk of ODA increases needs to be focused on supporting countries in this continent.

To achieve the MDGs, most of the new ODA resources must focus on supporting rigorous, practical and locally owned national development strategies that are ambitious enough to achieve the Goals. Many well-governed African countries – such as Ethiopia, Ghana, Senegal, Tanzania, and Uganda – are able to invest this ODA immediately in scaled-up programmes for health, education, basic infrastructure and environmental management. Indeed, if such countries are to start making the practical investments needed to achieve the MDGs within a decade, they urgently need to be “fast-tracked” with scaled-up donor assistance, starting in 2005. Other countries should similarly be encouraged to put forward such MDG-based strategies as soon as possible, backed by donor commitments to provide adequate finance once these strategies are ready for implementation.

In the near term, a significant portion of new resources should also be allocated to ‘quick wins’ - actions that can be implemented immediately within current capacity to save and improve millions of lives. Examples could include a joint EU-New Partnership for Africa's Development (NEPAD) initiative to fight malaria through the mass-distribution of long-lasting insecticide-treated nets and artemisinin-based combination therapy; a global initiative against hunger focusing on school meals, using locally produced food; or the ending of all user fees for essential healthcare and primary education, backed up by increased development assistance to make up for the revenue shortfall. Each of these quick wins requires significant upfront funding in 2005-2008.

### The need for an effective European aid mechanism

Taken together, the EU-15 countries already devote 0.35% of GNI to development assistance, which compares to an aggregate average of 0.19% for the non-EU donors. Four EU countries have already surpassed the 0.7% target: Denmark, Luxembourg, Netherlands, and Sweden. A fifth 0.7% donor, Norway, is part of the European Economic Area. Six other EU Member States – Belgium, Finland, France, Ireland, Spain and the UK – have set targets to reach 0.7% before 2015. The remaining five – Austria, Germany, Greece, Italy, Portugal – have committed themselves to reaching at least 0.51% by 2010 and 0.7% by 2015. Meanwhile, the new EU Member States have agreed to raise their ODA to 0.17% by 2010 and 0.33% by 2015. Taken as a whole, the EU will mobilise an additional estimated €30 billion by 2010 and €54 billion by 2015 compared with 2004 levels (at 2003 prices and exchange rates).<sup>1</sup> If this is focused on sub-Saharan Africa, the EU will be able to finance most of the continent's ODA needs for achieving the MDGs.

Yet even with these commitments to increased aid volumes, the coordination, quality and effectiveness of European aid must be improved if it is to deliver on its potential to reduce poverty. Currently, the EU-15 aid is delivered by 16 different sets of development agencies (including the European Commission) which are only partly coordinated. This fragmentation is a key factor contributing to the insufficient quality of existing ODA. Based on OECD/Development Assistance Committee (DAC) data, the Millennium Project estimates that less than one quarter of bilateral aid to low-income countries directly supports ground-level investments to achieve the Millennium Development Goals. In comparison, the share of multilateral aid that directly supports the Goals is more than 50%.

Unless this fragmentation of European development assistance is overcome, the high costs of coordination will continue to curtail the effectiveness of European ODA. In parallel, despite being the most generous donor region in the world, the EU and its Member States will continue to get much less international credit than they deserve for the development assistance they do provide. Coordinating essential policies, such as trade and competition, at the EU level is of course nothing new for European countries. The same principles underline the need for coordinated European development finance.

Making the most of Europe's increasing development assistance will require the pooling of resources and joint disbursement through a common mechanism. Fortunately, such a mechanism already exists in the form of the EDF. A major share of the programmed increases in ODA should therefore be channelled through the EDF. However, the EDF will need to be fundamentally reformed to be able to live up to its promise.

A reformed and expanded EDF would combine several characteristics to yield significant benefits for both its contributors and its beneficiaries:

- *European.* Strategic collaboration in aid would provide Europe with the international credit it deserves.
- *Effective.* Pooled resources would ensure the most effective use of public resources for development assistance by overcoming current donor fragmentation and offering an effective means of providing needed budgetary support to well-governed countries. A single vehicle could be used to serve the needs of many countries across all sectors.
- *Immediate.* A reformed EDF would allow Europe to launch global initiatives for the quick wins immediately and to support the "fast-tracking" of countries for the MDGs.
- *Predictable.* The funds allocated to a reformed EDF could be committed over longer periods of time than typical one- or three-year national budget cycles, pooling the risks of macroeconomic instability and allowing recipient countries dramatically greater ability to invest in needed long-term investments, such as those for human-resource development and capacity-building.
- *Flexible.* The reformed EDF would constitute an ideal vehicle for implementing innovative financing mechanisms.
- *Scalable.* The reformed EDF can be scaled up in due course using contributions from the new EU Member States and other partners as new donors.

## **A unique opportunity for reforming the EDF**

The need to reform the EDF has been clear for some time. Funding and reporting procedures are notoriously bureaucratic and, as a result, large shares of EDF funds have not been disbursed to recipient countries. The complexity of EDF procedures prevents many countries from applying for EDF funding. Most development professionals do not understand how the EDF works and how funding can be applied for. While EU Member States and the Commission agree that the EDF needs to be reformed, recent initiatives seem to have fallen short in bolstering the programme's efficacy.

There is no doubt that reforming the EDF will be a political challenge, but, right now, Europe has a unique opportunity to achieve just such a structural breakthrough. The landmark May 24 announcement by the Council of Ministers of its intention to achieve the 0.7% target by 2015 and the upcoming September World Summit in New York – expected to be the largest-ever gathering of world leaders – have focused the minds and attention of European decision-makers on implementation of the MDGs. In

addition, the ongoing budget negotiations for the period 2007 to 2013 and the programming of the 10th EDF mean that EU budget processes are in phase with a fundamental reform of the EU's development finance architecture.

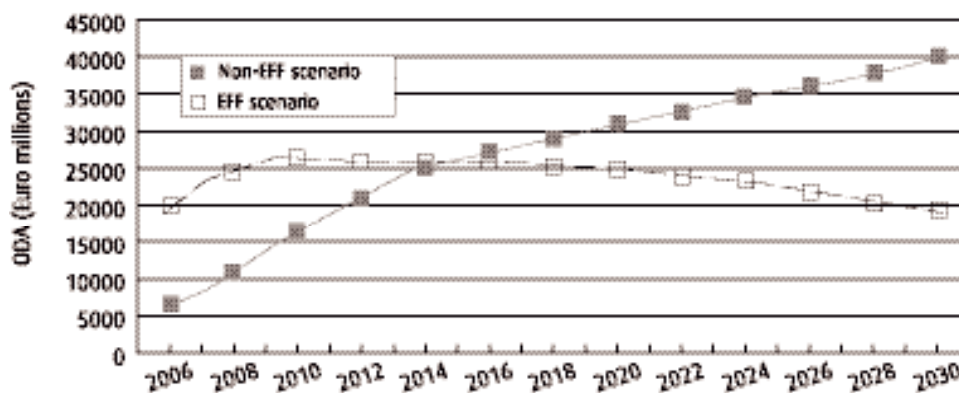
While the details of the reform are complex and will need to be worked out over coming months, some key elements of a solution can already be identified. A key obstacle to past reform efforts has been uncertainty over the level of funding provided to EDF by each EU Member State. The Council's announcement offers a framework for removing this obstacle. For example, member countries can agree to channel 50% of incremental development assistance through a reformed EDF. To ensure effective delivery of aid, programming for the 10th EDF should follow the example of one of the most successful multilateral financing mechanisms – the World Bank's International Development Association (IDA). Aid would be made available in the form of concessional budget support on the basis of MDG-based national development strategies prepared by developing countries. Indeed, the EDF would no doubt work in tandem with the IDA on many programmes targeting countries where aid can be used effectively. Unlike the IDA, however, the EDF needs to provide 100% grant financing as required to meet the MDGs in the poorest countries. It should also fund broad multi-country initiatives, such as an African initiative to fight malaria, regional infrastructure programmes or regional environmental management initiatives. In addition to capital costs, the EDF should also finance recurrent expenditures, which account for the bulk of resources required in the social sectors.

## A financing scenario for the reformed EDF

Currently, roughly €3.5 billion of European ODA is programmed through the EDF. An expansion of the EDF could be financed through an agreement by EU Members to set aside 50% of their planned ODA increases for this. If all EU Member States meet the ODA targets announced by the Council of Ministers, the EDF would receive approximately €4.7 billion in 2006, rising to €15.1 billion by 2010 and €26.8 billion by 2015 (at 2003 prices and exchange rates). Additional funding could be secured, as appropriate, by reprogramming aid from existing Community-wide funds like EuropeAid and European Community Humanitarian Office (ECHO).

The financing of the EDF could be bolstered by a European Finance Facility (EFF), based on the International Finance Facility concept championed by UK Chancellor Gordon Brown. An EFF could enable the frontloading of aid to support the urgently needed step-increase in development assistance during 2006, as underscored by the Africa Commission and the Millennium Project. Such an EFF would make a critical contribution to financing MDG-based development strategies and quick wins over the next two to three years. It would also firmly anchor Europe's leadership role in supporting practical programmes to achieve the MDGs.

Figure 1 shows two possible EDF disbursement paths over a 25-year scenario, respectively with and without frontloading support from an EFF.<sup>2</sup>



## Medium-term innovative financing options

The recent Landau Report established a strong case for innovative financing mechanisms to supplement development assistance for poor countries and finance international public goods. Several new mechanisms, such as an EFF, can be implemented right away through the voluntary participation of supporting countries. Others will take longer to implement, but should nonetheless be explored as expeditiously as possible as sources of financing for increased development assistance.

A reformed EDF offers an effective vehicle for implementing innovative financing mechanisms on a Europe-wide basis. A particularly compelling financing option consists of the partial selling of carbon emission rights under the EU's Greenhouse Gas Emission Trading Scheme. Instead of handing out all emission permits free of charge, as is currently the case, a small share of permits (say 10%) could be auctioned to emitters during 2007, when the next round of permits will be issued. Such a partial selling of carbon emission rights constitutes an efficient tax and could contribute substantially to funding the EDF.

Other promising innovative financing mechanisms, such as taxes on passenger air travel, are described in the Landau report and should be considered over the coming years. They could complement national efforts to reach the 0.7% target by 2015 to ensure that sufficient funding is available to support the achievement of the MDGs and other longer-term development objectives beyond 2015.

## The need for urgent action

In the first half of 2005, European leaders have already taken historic steps to help halve extreme poverty within a generation. The challenge now is to translate this political breakthrough into practical programmes which will help developing countries, especially African countries, to achieve the Millennium Development Goals. A unique window of opportunity exists to engage the political leadership of the EU Member States and the European Commission in reforming the European Development Fund. Fortunately, the technical and political challenges will undoubtedly pale in comparison to the rewards of meeting the Goals under European leadership. European leaders have shown that they can, and indeed must, rise to the occasion by announcing the urgent expansion and reform of the EDF this summer.

**Jeffrey Sachs is Director of the Earth Institute at Columbia University, where John McArthur is Associate Director. Guido Schmidt-Traub is a Policy Advisor at the Millennium Project. The views expressed here are those of the authors alone.**