

WHAT FUTURE



FOR EU

DEVELOPMENT

COOPERATION

IN MIDDLE-INCOME

COUNTRIES?

**THE STATE OF PLAY OF
NEGOTIATIONS BETWEEN
THE EU INSTITUTIONS**

Siân Herbert



BOND

BOND IS THE MEMBERSHIP BODY FOR UK INTERNATIONAL DEVELOPMENT ORGANISATIONS UNITED BY A COMMON GOAL TO ERADICATE GLOBAL POVERTY AND INEQUALITY. WE HAVE 400 MEMBERS RANGING FROM LARGE DEVELOPMENT AND HUMANITARIAN AGENCIES WITH A WORLD-WIDE PRESENCE TO SMALLER, SPECIALIST ORGANISATIONS WORKING IN CERTAIN REGIONS OR WITH SPECIFIC GROUPS OF PEOPLE. TOGETHER WE INFLUENCE GOVERNMENTS AND POLICY-MAKERS, DEVELOP THE SKILLS OF PEOPLE AND IMPROVE THE EFFECTIVENESS OF ORGANISATIONS, AND PROVIDE OPPORTUNITIES TO SHARE INFORMATION, KNOWLEDGE AND EXPERTISE ON A BROAD RANGE OF ISSUES.

BOND.ORG.UK

OVERSEAS DEVELOPMENT INSTITUTE

THE OVERSEAS DEVELOPMENT INSTITUTE (ODI) IS THE UK'S LEADING INDEPENDENT THINK TANK ON INTERNATIONAL DEVELOPMENT AND HUMANITARIAN ISSUES. WE AIMS TO INSPIRE AND INFORM POLICY AND PRACTICE WHICH LEAD TO THE REDUCTION OF POVERTY, THE ALLEVIATION OF SUFFERING AND THE ACHIEVEMENT OF SUSTAINABLE LIVELIHOODS IN DEVELOPING COUNTRIES. WE DO THIS BY LOCKING TOGETHER HIGH QUALITY APPLIED RESEARCH, PRACTICAL POLICY ADVICE, AND POLICY-FOCUSED DISSEMINATION AND DEBATE.

ODI.ORG.UK

PUBLISHED APRIL 2013

The views presented in this paper are those of the author and do not represent the Overseas Development Institute (ODI) or Bond. The author would like to thank Bond, Mikaela Gavas and Simon Maxwell for peer review and the interviewees consulted.

CONTENTS

Executive summary	2
Introduction	4
1. Background	5
- Rationale for differentiation	6
- Timeline	7
2. The proposals	8
- What are the new aid allocation criteria?	8
- Which countries should lose grant-based bilateral aid?	10
- Should aid be cut or phased out?	11
- What will replace grant-based bilateral aid?	12
3. Member state views on Development Cooperation Instrument differentiation of eligibility	13
4. A different approach for the European Development Fund	14
5. Conclusion	17
Bibliography	18
Annexes	20

EXECUTIVE SUMMARY

THE EUROPEAN COMMISSION'S PROPOSED POLICY OF 'DIFFERENTIATION' AIMS TO RECALIBRATE AID AND DEVELOPMENT COOPERATION IN MIDDLE-INCOME COUNTRIES. DIFFERENTIATION IS A KEY FEATURE OF THE EU'S NEW DEVELOPMENT STRATEGY – AN AGENDA FOR CHANGE – AND WILL SHAPE THE FUTURE OF EU DEVELOPMENT COOPERATION OVER ITS MULTI-YEAR BUDGET PERIOD THAT WILL RUN FROM 2014 TO 2020.

The policy will determine the allocation of EU development aid to developing countries, shape decisions on the type of modalities used and the sector focus in middle-income countries, and will ultimately change the EU's relations with these countries. The policy of differentiation proposes changes at three distinct levels:

1. eligibility criteria for grant-based bilateral aid
2. the share of aid to low-income countries, least developed countries and fragile states
3. differentiated development partnerships

The details of the policy are still under negotiation, and will be finalised over the course of 2013. Officially, under current plans, differentiation will be applied 'first' to the Development Cooperation Instrument. Informally, the European Commission has indicated that differentiation will also be applied to the European Development Fund but in a different way to the Development Cooperation Instrument.

There is general agreement on the principle of differentiation across the EU institutions – that the EU should reduce in number its grant-based bilateral aid programmes and focus more development funds on least developed countries, low-income countries and fragile states. However, the European Commission, member states and the European Parliament have demonstrated different perspectives on how the policy should be implemented.

The main areas of contention are:

1. The criteria used for eligibility of grant-based bilateral aid.

The European Commission and the Council of Ministers's criteria have a stronger focus on income and size of economy as key indicators, whilst the European Parliament suggests additional criteria focused on poverty indicators.

2. The list of countries that will be included and exempted from the policy.

The European Commission, the Council of Ministers and the European Parliament are divided on whether the eligibility criteria should: a. detail a strict no-exception approach; b. allow for only a few named exceptions; c. allow for an exception clause, with a few named exceptions; or d. allow for an exception clause without naming countries. Underpinning this issue are debates over individual countries especially South Africa, Ecuador, Peru, Colombia and Cuba.

3. Whether grant-based bilateral aid should be cut or phased out.

The European Commission initially proposed that aid should be cut, however both the Council of Ministers and the European Parliament have included wording for phasing out grant-based bilateral aid in 'exceptional cases'. This indicates that phasing out may be a likely addition.

4. The type of modalities that will 'replace' grant-based bilateral aid.

The European Commission's proposed 'differentiated development partnerships' will offer different types of modalities including blended finance, technical cooperation or support for trilateral cooperation. To date, the European Commission has provided little detail on what these differentiated development partnerships will involve, what type of modalities will be used in particular countries and the quantity of funds allocated to them. Similarly, the European Parliament and the Council of Ministers have also refrained from making concrete proposals in this area.

5. The different approach for the European Development Fund.

The European Commission initially considered applying the same model of differentiation to the European Development Fund as it proposed for the Development Cooperation Instrument. However, a mix of legal, political, economic and developmental factors underpin the decision not to propose differentiated eligibility to aid for the European Development Fund.

In addition to diverging views across the EU institutions, member states themselves have differing views. Four distinct positions can be grouped into:

1. those who want a clear and concise definition of differentiation enshrined in the Development Cooperation Instrument regulation, with no exceptions to the criteria
2. those who want a certain amount of flexibility to include or exclude countries throughout the multi-annual budget period
3. those who want named exceptions
4. those who are sceptical of the policy

INTRODUCTION

The European Commission proposed policy of 'differentiation' aims to recalibrate aid and development cooperation in middle-income countries. The policy responds directly to recent changes in global poverty and wealth patterns, economic flows and geopolitical realities. In an increasingly heterogeneous development landscape, the EU has initiated a multifaceted approach in an effort to 'differentiate' between the diverging needs and capacities of developing countries.

Differentiation is a key feature of the EU's new development strategy, *An Agenda for Change*, and will shape the future of EU development cooperation over its multi-year budget period that will run from 2014 to 2020 (European Commission, 2011a). The policy will determine the allocation of EU development aid to developing countries, shape decisions on the type of modalities used and the sector focus in middle-income countries, and will ultimately change the EU's relations with these countries.

This background note provides an overview of the state of play of negotiations on differentiation, with a focus on the Development Cooperation Instrument and the European Development Fund. The first section briefly explains the background to the new policy, the rationale and the timeline for negotiations. The second section focuses on the different, evolving positions of the European Commission, the member states and the European Parliament. The third section focuses on the different positions of key member states in the negotiations over the Development Cooperation Instrument. Finally, the third section examines how the European Commission's proposals differ for the Development Cooperation Instrument and the European Development Fund and explores the reasons why.

The policy of differentiation proposes changes at three distinct levels:

Aid allocation:

1. introducing eligibility criteria for grant-based bilateral aid (leading to aid 'graduation')
2. increasing the share of aid to low-income countries, least developed countries and fragile states

Aid modalities:

3. differentiated development partnerships

While not a new principle, differentiation has gained more prominence since 2011, and it is now a key feature of the EU's new development strategy *An Agenda for Change*¹ (European Commission, 2011a). At the end of 2011, the European Commission released legislative proposals for the financial instruments (called 'Regulations' - see Box 1). Regulations are the legal bases for the financial instruments and govern the spending.² They are proposed by the European Commission, and subsequently negotiated by the Council of Ministers and the European Parliament, with the European Commission and the rotating Presidency acting as brokers.³

In response to the European Commission's proposals, in May and June 2012, the Council of Ministers released two documents setting out its approach – the Council Conclusions on *An Agenda for Change* (Council of the EU, 2012a) and the Partial General Approach on the proposed regulations (Council of EU, 2012b). In September 2012, the European Parliament published its negotiating positions on the European Commission's proposed regulations for external action instruments (European Parliament, 2012a).

BACKGROUND

Box 1: Existing financial instruments for EU external action

Budget (2007-2013):

Geographic:

- Development Cooperation Instrument (€16.9 billion): 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 (€11.2 billion: European neighbourhood and Russia.
- Instrument for Pre-Accession (€11.5 billion): EU accession countries.
- Instrument for Cooperation with Industrialised Countries (€172 million).

Thematic:

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

Non-EU budget (2008-2013):

- European Development Fund (€22.7 billion): African, Caribbean and Pacific Group and Overseas Countries and Territories.

Source: Gavás (2010)

Officially, under current plans, differentiation will be applied 'first' to the Development Cooperation Instrument (European Commission, 2011b). Informally, the European Commission has indicated that differentiation will also be applied to the European Development Fund but in a different way to the Development Cooperation Instrument. These negotiations form part of wider negotiations over the EU's next long term budget. The EU plans its budget in seven-year periods – known as Multi-Annual Financial Framework - the next of which runs from 2014 to 2020.

Rationale for differentiation

'The EU must seek to target its resources where they are needed most to address poverty reduction and where they could have greatest impact'. Agenda for Change, European Commission, 2011a, p9.

Shifting global patterns of wealth, poverty, trade and geopolitical power have prompted many donors to change their aid allocation models, concessional benefits and ways of working with middle-income countries. The ongoing Eurozone crisis, austerity policies of many member states and fears of a global power shift from west to east have been particularly influential in shaping current thinking about development policy. The policy of differentiation has emerged amid this backdrop and has been discussed in the context of five overlapping objectives, identified in the table 1. Often these objectives are used in the same report or speech interchangeably, some are mutually exclusive and there are some tensions between the objectives. For example, in regards to fragile states, there is a tension between objective 2 (impact and value for money), and objective 1 (need) as work in fragile states may respond to greater need, however may also be expensive and not an easy environment to produce significant impact due to the volatility of the context.

Table 1: The different objectives of differentiation

Objectives	Source/s	Timeline
1. To target resources where they are needed ⁴ most (due to 'tight' development budgets)	(European Commission, 2011a; Piebalgs, 2011, 2012; European Commission, 2011b)	<p>In February 2013, EU leaders reached an agreement on the overall budget ceiling for the whole Multiannual Financial Framework and the shares across the budget areas (known as 'Headings') from 2014 to 2020. Development activities are funded through 'Heading 4 - Global Europe'. Budget negotiations are currently focused on the share of the budget going to each instrument within Heading 4.</p> <p>At the same time, negotiations over the regulations of the new external action instruments are taking place. Negotiations over the Development Cooperation Instrument began in 2012 and will likely continue until the end of 2013. Meanwhile, as the European Development Fund is based on an intergovernmental agreement, the European Parliament has no formal role in deciding on the budget or the details of the fund. Instead negotiations are between the Council of Ministers, the African, Caribbean and Pacific Group and the Overseas Countries and Territories.</p> <p>Differentiation has yet to be discussed between the Council of Ministers and the European Parliament. Both parties have indicated that they expect to reach an agreement by summer 2013 at the earliest.</p>
2. To target resources where they could have greatest impact and value for money	Agenda for Change (European Commission, 2011a) (Piebalgs, 2011, 2012)	
3. To provide new forms of partnerships for middle-income countries that graduate from grant-based bilateral aid, known as the 'differentiated development partnerships'. To shift relations with some emerging countries towards a partnership based on mutual interest rather than development cooperation	Agenda for Change (European Commission, 2011a) (Piebalgs, 2011, 2012)	
4. To respond better to the specific needs/capacities of each country	(European Commission, 2011e)	
5. Geographical differentiation (eg. to focus more on certain geographic regions, and less on others)	(European Commission, 2011f)	

Source: Herbert, 2013

THE PROPOSALS

Table 2: Criteria proposed for differentiation of eligibility for the Development Cooperation Instrument

What are the new aid allocation criteria?

The new proposed aid allocation criteria for eligibility mean that select countries will stop receiving a grant-based bilateral aid programmes from 2014 (known as ‘graduation’). This ‘first level’ of differentiation is new to EU development policy. This form of aid is administered through the geographic envelope of the Development Cooperation Instrument. However, countries will continue to be eligible for funding under thematic and regional programmes and through ‘differentiated development partnerships’.

The European Commission, the Council of Ministers and the European Parliament all agree on the principle of differentiation. However, they diverge particularly on the criteria used to determine ‘needs’ and ‘capacities’.

It is informally known that this new level of eligibility to grant-based bilateral aid will apply to the Development Cooperation Instrument and not to the European Development Fund (see section 3). Therefore, table 2 compares the different approaches for the Development Cooperation Instrument. Notably, the European Commission and the Council of Ministers’s criteria are focused on income and size of economy as key indicators, whilst the European Parliament suggests additional criteria focused on poverty indicators.

	Criteria proposed for differentiation of eligibility for the Development Cooperation Instrument (first level)
European Commission	<p>In general, the European Commission’s proposal focuses on income and size of economy as key indicators.</p> <p>Countries should graduate if they are:</p> <ul style="list-style-type: none"> • With a more than one per cent share of global gross domestic product (GDP) • Upper-middle-income countries according to the OECD-DAC classification • Additional criteria will be considered, including the Human Development Index, the Economic Vulnerability Index, aid dependency, economic growth and foreign direct investment
Council of Ministers	<p>In general, the Council of Ministers’s proposal focuses on income and size of economy as key indicators.</p> <p>The Council of Ministers supports broadly the same criteria as proposed by the European Commission. Countries should graduate if they are:</p> <ul style="list-style-type: none"> • With a more than one per cent share of global GDP • Upper-middle-income countries according to the OECD/DAC list <p>But, also includes possibility to maintain the geographic programme in ‘exceptional cases’.</p>
European Parliament	<p>In general, the European Parliament’s proposal focuses on human development, people poverty and inequality data as key indicators.</p> <p>The European Parliament argues that in exceptional cases, upper-middle-income countries should be eligible for grant based bilateral aid if they score:</p> <ul style="list-style-type: none"> • Below 0.75 on the Human Development Index⁵ • Above 10 per cent of the poverty headcount ratio (based on daily per capita net income of US\$2 (PPP, % of the population) • Above four per cent on the Poverty Gap Index (based on daily per capita net income of US\$2)⁶ • Above 45 per cent of the Income Gini Coefficient⁷

Source: Author’s construct, based on - European Commission, 2011c; Council of European Union, 2012b; European Parliament, 2012a.

At the ‘second level’ of differentiation, the European Commission has proposed to develop a new aid allocation formula that will allocate a higher share of funds to least developed countries, low-income countries and fragile states, and less to middle-income countries and high-income countries.⁸ This second level of differentiation will apply to both the Development Cooperation Instrument and the European Development Fund. This is not new, as the current allocation formula for each already allows for this. However, the weighting towards least developed countries, low-income countries and fragile states will be increased.⁹

The European Commission is currently exploring new formulas for this stage, and has yet to make details publically available. The European Commission is also exploring if it can apply the same quantitative formula to both the Development Cooperation Instrument and the European Development Fund. No final decisions regarding aid allocation per country can be made until the budget breakdown per instrument is decided.

The overarching principles set out in *An Agenda for Change* propose that EU development aid should be allocated according to: needs, capacities, commitments and performance, and potential EU impact. This updates the vision established in the 2005 European Consensus on Development, which only focused on: needs and performance (Council of the EU, 2005).

Crucially, the proposed rules governing the Development Cooperation Instrument do not explain how the indicators included in the criteria are weighted. So, although the aid allocation criteria are explained, the formula for country selection is not clear.

Table 3: Applying the criteria: what countries should be excluded from grant-based bilateral aid in the Development Cooperation Instrument

	Country selection
European Commission	<p>The European Commission has proposed option b - allow for only a few named exceptions.</p> <p>The Development Cooperation Instrument Regulation proposes:</p> <ul style="list-style-type: none"> • 19 countries to lose grant-based bilateral aid:¹⁰ <ul style="list-style-type: none"> - 17 upper-middle-income countries: Argentina, Brazil, Chile, China, Colombia, Costa Rica, Ecuador, Kazakhstan, Iran, Malaysia, Maldives, Mexico, Panama, Peru, Thailand, Venezuela and Uruguay - 2 low-middle-income countries: India and Indonesia • 2 exceptions: Cuba and South Africa
Council of Ministers	<p>The Council of Ministers has proposed option d - allow for an exception clause without naming countries. However, it is important to note that member states' positions on this issue vary between options a, b, c, and d (detailed further in Section 4).</p> <p>The Partial General Approach removes the two annexes (II and III) from the Development Cooperation Instrument regulation, which details the countries eligible for geographic envelopes. This leaves the criteria as the only point of reference for country selection – which is in turn guided by the OECD-DAC list. In practice this means a proposal where:</p> <ul style="list-style-type: none"> • 21 countries potentially lose grant-based bilateral aid: the 19 proposed by the European Commission, plus Cuba and South Africa • No named exceptions, but a clause could allow for exceptions at a later stage
European Parliament	<p>The European Parliament has proposed option c - allow for an exception clause, and a few named exceptions:</p> <p>The negotiating mandate proposes:</p> <ul style="list-style-type: none"> • 16 countries to lose bilateral grant-based aid: <ul style="list-style-type: none"> - 14 upper-middle-income countries: Argentina, Brazil, Chile, China, Costa Rica, Kazakhstan, Iran, Malaysia, Maldives, Mexico, Panama, Peru, Thailand, Venezuela, Uruguay - 2 lower-middle-income countries: India and Indonesia • 5 exceptions:¹¹ Colombia, Cuba, Ecuador, Peru and South Africa • A clause could also allow for more exceptions at a later stage <p>Interestingly, if the criteria proposed by the European Parliament are followed (as detailed in annex 1, table 6), then eight Development Cooperation Instrument countries would qualify as exceptions: Brazil, China, Colombia, Ecuador, India, Indonesia, Peru and South Africa (as detailed in annex 1, table 6). Cuba does not qualify on any one of the four criteria.</p>

Source: Author's construct, based on - European Commission, 2011c; Council of European Union, 2012b; European Parliament, 2012a.

Which countries should lose grant-based bilateral aid?

A second key point of debate is how to apply the criteria – two issues are under discussion. First, the European Commission, the Council and the European Parliament are divided on whether the Development Cooperation Instrument Regulation should:

- a.** detail a strict no-exception approach
- b.** allow for only a few named exceptions
- c.** allow for an exception clause, with a few named exceptions
- d.** allow for an exception clause without naming countries

Second, underpinning the first option are debates over individual countries – especially South Africa, Ecuador, Peru, Colombia and Cuba. Table 3 compares the positions of the three EU institutions.

Should aid be cut or phased out?

A third issue of debate is whether grant based bilateral aid should be cut or phased out. The European Commission initially proposed that aid should be cut, however both the Council of Ministers and the European Parliament have included wording for phasing out grant-based bilateral aid in 'exceptional cases'. This indicates that phasing out may be a likely addition. Table 4 compares the three positions of the EU institutions.

Interestingly, the idea that all grant-based bilateral aid could be stopped from 2014 onwards is not entirely correct, as many EU-funded initiatives will actually run for multi-year periods past 2014. When the European Commission commits funds, the funds must be disbursed within three years, so this means that some initiatives committed in 2013 will still be operating in 2016. These initiatives would be using funds from the current Multiannual Financial Framework (2007-2013). So it would be more appropriate to say that no new grant-based bilateral aid funds will be committed or disbursed after 2014, rather than grant-based bilateral aid will be cut from 2014.

In a sense, this means that there is a natural phasing out period already built into the geographic programmes. If the EU institutions were to agree to a phasing out period of, for example, three years, it could mean that some countries would continue to receive grant-based bilateral aid until the end of the budget period in 2020 (ie. business as usual).

Table 4: EU institutions positions on 'cutting' or phasing out grant-based bilateral aid in the Development Cooperation Instrument

	Grant-based bilateral aid 'cut' or phased out
European Commission	'Cut' ¹²
Council of Ministers	Phase out in 'exceptional cases'
European Parliament	Phase out to 'exceptional countries' with vulnerable constituencies

Source: Author's construct, based on - European Commission, 2011c; Council of European Union, 2012b; European Parliament, 2012a.

MEMBER STATE VIEWS ON DEVELOPMENT COOPERATION INSTRUMENT DIFFERENTIATION OF ELIGIBILITY

What will replace grant-based bilateral aid?

The third level of differentiation – differentiated development partnerships – will offer different types of modalities to some or all of the countries that graduate from grant-based bilateral aid. Differentiated development partnerships differ from the previous development relationships in that they will be based primarily on blended finance¹³, technical cooperation¹⁴ or support for trilateral cooperation (European Commission, 2011a).¹⁵

Some European Commission sources have suggested that some of the countries that will graduate may receive the same amount of European Commission funding as before, but administered through different instruments. However, other sources have indicated that this would be highly unlikely when considering the limited amount of funds available in other funding streams (Herbert, 2013). Furthermore, it has been argued that this would contradict the purpose of differentiation, which is to ensure least developed countries, low-income countries and fragile states receive proportionally more EU funds.¹⁶

To date, the European Commission has provided little detail on what these differentiated development partnerships will involve, what type of modalities will be used in particular countries and the quantity of funds allocated to them. Similarly, the European Parliament and the Council of Ministers have also refrained from making concrete proposals in this area. An analysis of inputs from member states suggests that the following could also be included: directing funds to civil society, twinning, knowledge sharing, technological cooperation, cultural cooperation, public-private partnerships, capacity development for individuals and organisations, and consultancy and dialogue measures (Herbert, 2012a).¹⁷

While section 2 examines the official proposals from the Council of Ministers on differentiation, it is clear that these positions are the result of a compromise between diverging member state positions. It could be said that there are four distinct positions within the Council of Ministers:

Group 1 – strict differentiation

This group wants a clear and concise definition of differentiation enshrined in the Development Cooperation Instrument regulation, with no exceptions to the criteria. This group agreed to allow the ‘exceptional countries’ wording into the Partial General Approach as a compromise to ensure the policy would be included.

Group 2 – flexible differentiation

This group was initially part of Group 1, however it latterly emerged as a subgroup. Similarly to Group 1, this group wants a clear and concise definition of differentiation enshrined in the Development Cooperation Instrument Regulation, however, it also wants a certain amount of flexibility to include or exclude countries throughout the multi-annual budget period.

This group is particularly keen to exclude the list of country selection from the Development Cooperation Instrument annexes, so as to avoid discussion of individual countries and the risks that this poses to developing coherent criteria.¹⁸ Instead, it argues that the OECD-DAC list should be the only reference made in the document. This combined with the ‘exceptional countries’ clause would allow the EU extra flexibility to

consider exempting countries on a case-by-case basis.¹⁹ At the same time, the simple strict criteria proposed by the European Commission would reduce the pressure on the EU to exempt countries if it does not want to.

Group 3 – strict differentiation with exceptions

Like the first two groups, this group supports the principle of differentiation, and the need for clear and concise criteria. However, it supports the inclusion of a country list in the annex to the Development Cooperation Instrument Regulation to ensure that Cuba and South Africa are named as exceptions. In contrast to Group 2, this group wants these exceptions to be confirmed in a legal text. This group has particularly highlighted that South Africa – as the only African country in the Development Cooperation Instrument – does not have access to a separate regional fund, so it should keep the geographic envelope to maintain this.

Group 4 – differentiation sceptics

This group is generally sceptical about the limitations and inflexibility of the policy, the criteria and the inclusion of the country list. These countries tend to have different reasons for supporting this position. As Latin America will be the region most affected, this group has expressed concerns about how the EU will maintain relationships with Latin America as a region, and also individual countries, without the geographic envelope.

A DIFFERENT APPROACH FOR THE EUROPEAN DEVELOPMENT FUND

The European Commission initially considered applying the same model of differentiation to the European Development Fund as it proposed for the Development Cooperation Instrument. This final section examines the context and reasons why the European Commission has decided to apply two different types of aid differentiation to these instruments. The European Commission's impact assessment for the next European Development Fund (2014-2020), suggested a universal approach should be taken:

'...despite the different funding sources of EU development cooperation (ie. mainly the European Development Fund and the Development Cooperation Instrument), the specific objectives and modalities of the updated EU development policy will be applied equally to all developing countries through the various financial instruments. This includes, in particular, applying a more differentiated approach...' (European Commission, 2011e)

An *Agenda for Change* noted that the policy of differentiation should apply to 'all regions', except for the neighbourhood and Sub-Saharan Africa regions (European Commission, 2011a).

Meanwhile, when questioned by the UK Parliament's International Development Committee during their inquiry into EU development assistance, Commissioner Piebalgs affirmed that the Cotonou Agreement makes the EU-African, Caribbean and Pacific Group a 'special relationship', and he indicated that the policy approach may differ for the group:

'...what we intend to propose is strong differentiation according to the level of income. But for the Caribbean I have a bit of a soft spot because the countries are vulnerable to two major challenges: climate change and natural disasters. It is the same with the Pacific...They are vulnerable economies that in a way deserve some attention even if the income per capita is there' (House of Commons International Development Committee, 2012).

In response to these messages, in August 2012, the African, Caribbean and Pacific Group officially announced its 'concerns' regarding the extension of differentiated eligibility to grant-based bilateral aid to the European Development Fund. Following discussions between the two groups, the European Commission confirmed informally that it would not propose applying differentiation of eligibility to the European Development Fund²⁰ (the first level) but that it plans to propose an

increased differentiation of the share of aid going to least developed countries, other low-income countries and fragile states (the second level). The second level is already a feature of EU- African, Caribbean and Pacific cooperation, and is not a principle that is contested by the group. However, within the group, some countries are concerned about potentially significant decreases in aid to the upper-middle-income countries, this was recently noted at a meeting with EU and Caribbean country officials:

"The meeting expressed its concern on the proposed EU policy of differentiation and requested a gradual phasing out procedure to be applied to the affected middle-income countries".²¹

In order to understand why differentiated eligibility was not proposed for the European Development Fund, table 5 compares it with the Development Cooperation Instrument, according to the European Commission's proposed criteria for differentiation of eligibility.

Table 5: Comparing the Development Cooperation Instrument and the European Development Fund

	Development Cooperation Instrument (2007-2013)	European Development Fund (2008-2013)
Total number of countries in instrument	46	77 ²²
Countries that meet the European Commission's differentiation of eligibility criteria	19 upper-middle-income countries: Argentina, Brazil, Chile, China, Colombia, Costa Rica, Ecuador, Kazakhstan, Iran, Malaysia, Maldives, Mexico, Panama, Peru, Thailand, Venezuela, Uruguay, Cuba, South Africa 2 low-middle-income countries with more than 1 per cent of the world's GDP: India and Indonesia	21 upper-middle-income countries and high-income countries: Namibia, Jamaica, Dominican Rep., Suriname, St. Vincent and the Grenadines, Palau, St. Lucia, Dominica, Botswana, Grenada, Gabon, Mauritius, Seychelles, St. Kitts and Nevis, Barbados, Antigua and Barbuda, Trinidad and Tobago, Bahamas, Cook Islands, Nauru, Niue No country registered as having more than a 1 per cent share of global GDP in 2012
Countries under discussion for exception status	Colombia, Cuba, Ecuador, Peru and South Africa	None – differentiation of eligibility has not been proposed
Funds that could be freed up through differentiation of eligibility	An estimated €2.8 billion ²³ could be freed up from 2014 to 2020, by applying only the differentiated eligibility criteria. More funds would be freed up at the programming stage	An estimated €1.2 billion ²⁴ could be freed up from 2014 to 2020, by applying only the differentiated eligibility criteria. More funds would be freed up at the programming stage

Source: Author's construct

A mix of legal, political, economic and developmental factors underpin the decision not to propose differentiated eligibility to aid for the European Development Fund. First, as the Cotonou Agreement is a legally binding 'intergovernmental' agreement, the possibility of extending differentiation to the European Development Fund has proven a controversial topic. Opinions vary as to whether it would be legally possible under the current agreement, or whether the agreement would need to be modified. Article 2 of the Cotonou Agreement says:

'differentiation and regionalisation: cooperation arrangements and priorities shall vary according to a partner's level of development, its needs, its performance and its long-term development strategy'

Therefore, it could be maintained that the Cotonou Agreement already allows for differentiation. However, the important question is whether this the same type of differentiation as that launched in *An Agenda for Change*. The interpretation of this marks a point of departure in the debate.

In Vanuatu in 2012, Commissioner Piebalgs argued that based on Article 2, 'The question is not therefore whether this principle should be taken into account, but how'. He then suggested two options: the first – increased differentiation in aid allocation only; the second – differentiation of eligibility. In response, the former Secretary General of the African, Caribbean and Pacific Group, Dr Mohamed Ibn Chambas, argued that 'The inclusion of the element of graduation...in our view is not within the spirit of the Second Revision of Cotonou'.²⁵ Considering that the Development Cooperation Instrument and European Development Fund are based on different legal and financial terms, it is relevant to question the validity of comparing one to the other at all.

Differentiation in the share of aid allocation has been a feature of EU-African, Caribbean and Pacific Group relations since 2000, with explicit provisions initiated by the Cotonou Agreement (Keijzer et. al., 2012). However, differentiation of eligibility is a new element introduced in *An Agenda for Change*. This distinction is significant. If this type of differentiation is indeed new, then the decision to introduce it into the agreement would require approval by the Group, according to Articles 12 and 95. If the decision were to be approved, both parties would need to discuss whether Annex IV of the Cotonou Agreement would need to be modified (European Commission, 2011e). This presents the European Commission with a series of challenges, especially as members of the African, Caribbean and Pacific Group have indicated that it would not support this.

Second, without the agreement of the African, Caribbean and Pacific Group, the European Commission would find it politically difficult to pursue the application of the policy. Debates over differentiated eligibility to aid could risk damaging the solidarity of the group, and forcing divides between 'winners' and 'losers'; this is particularly relevant in light of internal discussions over the future of the Group. Most importantly, the African, Caribbean and Pacific Group still wants aid for all its members, as former Secretary General Dr Mohamed Ibn Chambas said in 2012:

"We believe that African, Caribbean and Pacific countries that have achieved favourable economic performance should be supported to transition into a more stable and sustainable growth path".²⁶

Third, a relatively small amount of money would be freed up from applying differentiated aid eligibility to the European Development Fund – an estimated €1.2 billion over the next seven years (see Table 5). Fourth, in relation to development, the European Development Fund already has the strongest country poverty focus of all the EU's development instruments. The 21 upper-middle-income countries and high-income countries named in table 5 receive a very low share of EU aid, as most have small populations. 18 of these 21 countries are small-island developing states, many with vulnerabilities to environment and economic shocks.²⁷ Out of the 21 upper-middle-income countries, 17 score highly on the Environmental Vulnerability Index. Also, the prioritisation in *An Agenda for Change* of Sub-Saharan Africa would support keeping in Botswana, Namibia and Gabon.

CONCLUSION

The EU's policy of differentiation will determine the allocation of EU development aid to developing countries, shape decisions on the type of modalities used and the sector focus in middle-income countries, and will ultimately change the EU's relations with these countries.

The broad principles of differentiation – as set out in *An Agenda for Change* – have been agreed by all three EU institutions. Differentiation has yet to be discussed between the Council of Ministers and the European Parliament as part of the negotiations over the regulations of the financial instruments. Both parties have indicated that they expect to start negotiations on the issue within the next two months and to reach an agreement by the summer, at the earliest. In the meantime, discussion continues around the five areas of contention highlighted in the paper:

1. The criteria used for eligibility of grant-based bilateral aid
2. The list of countries that will be included and exempted from the policy
3. Whether grant-based bilateral aid should be cut or phased out
4. The type of modalities that will 'replace' grant-based bilateral aid
5. The different approach for the European Development Fund

BIBLIOGRAPHY

Council of the EU (2012a) 'Council conclusions: 'Increasing the Impact of EU Development Policy: an Agenda for Change' consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/130243.pdf

Council of European Union (2012b) 'Partial General Approach' <http://register.consilium.europa.eu/pdf/en/12/st11/st11029.en12.pdf>

European Commission (2008) 'Reforming Technical Cooperation and Project Implementation Units for External Aid provided by the European Commission: A Backbone Strategy' ec.europa.eu/development/icenter/repository/backbone_strategy_technical_cooperation_en.pdf

European Commission (2011a) 'Increasing the impact of EU development policy: An Agenda for Change' eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0637:FIN:EN:PDF

European Commission (2011b) 'Multiannual Financial Framework 2014-2020: strengthening Europe's place in the world' ec.europa.eu/europeaid/how/finance/mff/financial_framework_news_en.htm

European Commission (2011c) 'Proposal for a regulation of the European Parliament and of the Council establishing a financing instrument for development cooperation' ec.europa.eu/europeaid/how/finance/documents/prop_reg_instrument_dev_coop_en.pdf

European Commission (2011e) Impact Assessment: Preparation of the multiannual financial framework regarding the financing of EU cooperation for African, Caribbean and Pacific States and Overseas Countries and Territories for the 2014-2020 period (11th European Development Fund) and covering the subsequent implementing and financial regulations of the 11th European Development Fund (EDF) eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2011:1459:FIN:EN:PDF

European Commission (2011f) 'Impact assessment accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: "Increasing the impact of EU development policy: An Agenda for Change"' ec.europa.eu/europeaid/what/developmentpolicies/documents/impact_assesment_en.pdf

European Commission (2011) 'Preparation of the Multiannual Financial Framework regarding the financing of EU cooperation for African, Caribbean and Pacific states and overseas countries and territories for the 2014-2020 period (11th European Development Fund)' ec.europa.eu/europeaid/how/finance/documents/comm_european_development_fund_en.pdf

European Commission (2011) 'Impact assessment accompanying the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: "Increasing the impact of EU development policy: An Agenda for Change"' ec.europa.eu/europeaid/what/development-policies/documents/impact_assesment_en.pdf

European Parliament and the Council (2006) 'Regulation (European Commission) No. 1905/2006 of the European Parliament and of the Council of 18 December 2006 establishing a financing instrument for development cooperation'. OJ L 378, 27 December eurlex.europa.eu/lex/LexUriServ/LexUriServ.do?uri=OJ:L:2006:378:0041:0071:EN:PDF

European Parliament (2012a) 'European Parliament's negotiating position: consolidated version' europarl.europa.eu/document/activities/cont/201210/20121001ATT52678/20121001ATT52678EN.pdf

Gavas, M., (2010) 'Financing European development cooperation: the Financial Perspectives 2014-2020' www.odi.org.uk/resources/docs/6238.pdf

Keijzer, et. al, (2012) 'Differentiation in ACP-EU Cooperation Implications of the EU's Agenda for Change for the 11th EDF and beyond' [ecdpm.org/Web_ECDPM/Web/Content/Download.nsf/0/61C23BAE0116E681C1257A950038CBB0/\\$FILE/Differentiation%20in%20ACP-EU%20Cooperation%20-%20Final%2011102012.pdf](http://ecdpm.org/Web_ECDPM/Web/Content/Download.nsf/0/61C23BAE0116E681C1257A950038CBB0/$FILE/Differentiation%20in%20ACP-EU%20Cooperation%20-%20Final%2011102012.pdf)

Herbert, S. (2013 forthcoming) 'The future of EU aid in middle-income countries: The case of South Africa', Working Paper 370, London: ODI

Herbert, S. (2012a) 'Reassessing aid to middle-income countries: the implications of the European Commission's policy of differentiation for developing countries', Working Paper 349, London: ODI odi.org.uk/publications/6658-aid-middle-income-countries-european-commission-differentiation

Herbert, S. (2012b) 'The Different Approaches to Differentiation', in te Velde (ed.), The next decade of EU trade policy: confronting global challenges? London: ODI odi.org.uk/publications/6693-eu-trade-policy-international-development-global-challenges#details

Herbert, S. (2012c) Presentation: 'Differentiation in EU policy' internationaldevelopmenteu.files.wordpress.com/2012/02/differentiation-and-eu-policy-sian-herbert-2-feb-2012.pdf

Piebalgs, A (2011) 'Statement by EU Commissioner for Development Andris Piebalgs on the budget proposals for EU external instruments from 2014-2020' europa.eu/rapid/press-release_MEMO-11-886_en.htm

Piebalgs, A. (2012) 'Aid has to be modernised; EU is not pulling out from middle income countries (MICs)', on European Commission blog blogs.ec.europa.eu/piebalgs/aid-has-to-be-modernised-eu-is-not-pulling-out-from-middle-income-countries-mics

Table 6: Development Cooperation Instrument country selection according to the European Parliament's proposed criteria²⁸

DCI countries that could have differentiation applied, that qualify for the European Parliament's criteria	Human Development Index: below 0.75	Poverty headcount ratio (based on daily per capita net income of US\$2 (PPP) (% of the population): above 10%	Poverty Gap Index (based on daily per capita net income of US\$2): above 4%	Income Gini Coefficient: above 45%	Number of criteria met	Countries that meet all four criteria
South Africa	1	1	1	1	4	1
Brazil	1	1	1	1	4	1
China	1	1	1	1	4	1
Colombia	1	1	1	1	4	1
Costa Rica	1			1	2	
Ecuador	1	1	1	1	4	1
India	1	1	1	1	4	1
Indonesia	1	1	1	1	4	1
Malaysia				1	1	
Maldives	1				1	
Mexico				1	1	
Panama		1	1	1	3	
Peru	1	1	1	1	4	1
Thailand	1				1	
Uruguay	1			1	2	
Venezuela	1	1			2	
Total	13	10	9	13		8

Source: Author's construct based on data provided by the European Parliament

REFERENCES

¹See document here: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0637:FIN:EN:PDF>

²See the proposed Regulation for development cooperation: http://ec.europa.eu/europeaid/how/finance/mff/financial_framework_news_en.htm

³For more information on the co-decision process (otherwise known as the 'community method') see here: http://www.europarl.europa.eu/code/information/guide_en.pdf

⁴'Need' is defined strongly along income lines with key criteria including GNI per capita and share of global GDP (Herbert, 2012a)

⁵The Human Development Index is a human development indicator developed by the UN. It measures the average achievements in a country in three basic dimensions of human development: a long and healthy life (health), access to knowledge (education) and a decent standard of living (income). A lower score means lower human development. More information available here: <http://hdr.undp.org/en/statistics/hdi/>

⁶The Poverty Gap Index measure: 'The mean distance below the poverty line as a proportion of the poverty line where the mean is taken over the whole population, counting the non-poor as having zero poverty gap. That is the mean shortfall from the poverty line (counting the non-poor as having zero shortfall), expressed as a percentage of the poverty line' (More information available here: <http://stats.oecd.org/glossary/detail.asp?ID=6336>)

⁷The Gini index measures the 'extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of zero represents perfect equality and 100, perfect inequality' (more information available here: <http://stats.oecd.org/glossary/detail.asp?ID=4842>)

⁸Notably, the DCI does not contain any HICs, the EDF includes one HIC – the Bahamas

⁹In the 2007-2013 DCI Regulation, 'the needs criteria include population, income per capita and the extent of poverty, income distribution and the level of social development' (EU, 2006). It is important to note that the weighting of criteria has not been made public. As mentioned above, differentiated eligibility to aid is a new feature in European Commission aid allocation, and therefore criteria with defined thresholds for eligibility are not detailed for the current MFF.

¹⁰Notably, 11 out of these 19 are from the Latin America region

¹¹Notably, Venezuela was also initially suggested by some MEPs as an exception <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-492.895+01+DOC+PDF+V0//EN&language=EN>

¹²See above explanation on 'cutting' aid, compared to phasing out

¹³Blended finance is a combination of market (or concessional) loans with grant (or grant equivalent) components. More information available at: <http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/6658.pdf>

¹⁴The European Commission's definition of technical cooperation is: 'Technical Cooperation is often associated with actions aimed at strengthening individual and organisational capacity by providing expertise (short and long term Technical Assistance (TA) personnel, institutional twinning arrangements, mobilisation of Diaspora, etc.), training and related learning opportunities (peer exchange, tertiary education, etc.), and equipment. TA refers to the personnel involved in the implementation and the management of technical cooperation services. (European Commission, 2008, p7).

¹⁵Triangular cooperation can be defined as partnerships between DAC donors and other donors (providers of South-South Cooperation) to implement development cooperation programmes/projects in beneficiary countries. More information is available at: <http://www.oecd.org/dac/46387212.pdf>

¹⁶This depends on what one thinks the key objectives are of the policy differentiation. Table 1 in Section 1 identifies five different objectives for the policy that have been cited by European Commission officials.

¹⁷The EU's 'Twinning' instrument is a good example of possible work in this area. This instrument is an institution-to-institution exchange programme, where staff from a Member State and a partner country are seconded for between one to three years. At present only neighbourhood countries are eligible for this, however there is discussion about extending it to other regions. More information here: http://ec.europa.eu/enlargement/tenders/twinning/index_en.htm

¹⁸Eg. it wants the discussion of the principles of differentiation to be separated and prior to discussions over individual countries (what could be called a technical approach versus a political approach). Having a fixed list of exceptions can be restrictive as over time the validity of certain countries being on the list can become obsolete as countries follow different development trajectories. Notably, this can also limit the responsiveness of the policy to changing circumstances. This is particularly relevant for the EU's medium term budget as it is negotiated for seven year periods.

¹⁹The UK, for example, was initially keen to keep Cuba and South Africa as exceptions, however has declined from enshrining these countries as exceptions so as to not make a precedent that other countries may creep into the exclusion list.

²⁰Press release: African, Caribbean and Pacific Group concerned about graduation, differentiation in EU aid policy <http://www.acp.int/content/press-release-acp-concerned-about-graduation-differentiation-eu-aid-policy>

²¹9th Caribbean Regional Meeting of the ACP-EU Joint Parliamentary Assembly in February 2013, http://www.europarl.europa.eu/intcoop/acp/2013_sdomingo/pdf/communique_finale_en.pdf

²²The African, Caribbean and Pacific Group has 79 countries, but South Africa and Cuba do not benefit from the EDF

²³The 19 Development Cooperation Instrument countries, proposed by the European Commission, were allocated approximately 27 per cent of the ODA budget for the current Multiannual Financial Framework through the geographic envelope. So, if we assume a similar percentage saving of 27 per cent in the geographic envelope in the next Multiannual Financial Framework, a figure of around €2.8 billion could be potentially be freed up from 2014 to 2020 (note: no decision has been made on the size of the Development Cooperation Instrument budget, relative to the other development instruments in Heading 4, so this calculation is indicative and is based on the assumption that the budget agreed for Heading 4 in February 2013 will lead to similar percentage cuts across each instrument). (Herbert, 2012a; and see: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf)

²⁴The 21 upper-middle-income countries and high-income countries were allocated approximately 5.3 per cent of the ODA budget for the current European Development Fund-10 through the European Development Fund national and regional indicative programmes envelope. So, if we assume a similar percentage saving of 5.3 per cent of the national and regional indicative programmes envelope in the European Development Fund-11, a figure of around €1.2 billion could be potentially be freed up from 2014 to 2020 (Note: this calculation is indicative) (www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf)

²⁵<http://www.acp.int/content/press-release-acp-concerned-about-graduation-differentiation-eu-aid-policy>

²⁶See: <http://www.acp.int/content/press-release-acp-concerned-about-graduation-differentiation-eu-aid-policy>

²⁷Jamaica, Dominican Rep., Suriname, St. Vincent and the Grenadines, Palau, St. Lucia, Dominica, Grenada, Mauritius, Seychelles, St. Kitts and Nevis, Barbados, Antigua and Barbuda, Trinidad and Tobago, Bahamas, Cook Islands, Nauru, Niue.

²⁸Data provided directly by the European Parliament.



Regent's Wharf
8 All Saints Street
London N1 9RL
United Kingdom

+44 (0)20 7837 8344
bond@bond.org.uk
bond.org.uk

Registered Charity No. 1068839
Company Registration No. 3395681
(England and Wales)

**“DIFFERENTIATION AIMS
TO RECALIBRATE AID
AND DEVELOPMENT
COOPERATION IN MIDDLE-
INCOME COUNTRIES.”**