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The EU's Development Policy Instruments

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Abstract

Development cooperation represents one of the key priorities of the EU external policies. Through development instruments, the Union is allocating financial contributions in less developed countries, thus helping their economies to develop and grow. The paper presented here deals with financial instruments of the EU and their application in less developed countries. European Development Fund, Development Cooperation Instrument, and Instrument for Pre-Accession Assistance are specially brought into focus. It concentrates on the spheres of development cooperation with both thematic and geographic aspects. For one of the poorest countries of the world, Ethiopia, there are presented data of flows of official development assistance which are compared with the flows in all developing countries by a visual analysis in the same period of 1960-2011. The correlation analysis is carried out to demonstrate the interdependence between the flows of official development assistance and some selected macroeconomic indicators on the example of Ethiopia as one of the beneficiary countries. Applying this method, we look into the relation between the official development assistance and the indicators of the country.

Keywords: Official Development Assistance, European Development Fund, Instrument for Pre-Accession Assistance, Development Cooperation Instrument, Ethiopia

Introduction

The development assistance program includes a range of international calls. On one hand, it stands for the expression of solidarity and responsibility for the global development, and for the promotion of economic cooperation with less developed countries on the other.

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Development assistance is a comprehensive concept by which we understand several specific development activities. We can define it as a transfer of financial flows, know-how, technologies and material goods from donors to beneficiary or recipient countries. Under Official Development Assistance (ODA) we understand an international transfer of public resources joining donor and recipient countries (Charnoz and Severino, 2007). The Organization for Economic Co-operation and Development defines the ODA as grants or loans to countries and territories on the DAC (Development Assistance Committee) List of ODA Recipients (developing countries) and to multilateral agencies which are undertaken by the official sector, with promotion of economic development and welfare as the main objective. Financial flows, technical co-operations are included in aid.

As for the subject matter (Rusnák, Szép and Brzica, 2002), the ODA can be divided into technical, material and financial assistance. Ferroni (2001) focuses on providing assistance in the form of public goods.

According to The Millennium Development Goals[2]Report (2009), there is a commitment in place to foster cooperation and partnership which are, in spite of a slow economic growth, covered also in the UN Millennium declaration. In times of a crisis too, development assistance to developing countries is needed since economic difficulties might arise in them. The European Union (EU) recognizes the seriousness of it. On global scale, it is providing more than a half of entire development assistance. The Union has pledged to reach a share of 0.7 % to its gross national product by 2015.

The EU is cooperating with ca. 160 countries nowadays. The EuropeAid represents the Directorate General of the European Commission for Development and Cooperation, being responsible for designing EU development policies and delivering aid through programmes and projects across the world. The Directorate, established in January 2011, is currently the only body responsible for planning and exercising most of EU development instruments. According to European Parliament (2013), the EuropeAid aims primarily at these goals:

[2]In September 2000, the Millennium Summit took place in New York where UN Members assembled. The aim of the Summit was to focus attention on the fight against poverty and promotion of sustainable development. This joint meeting of the world community resulted in adoption of the Millennium Development Goals – MDGs.

1. to reduce poverty in the world,
2. to ensure sustainable development
3. to promote democracy, peace and security.

This paper aims to present the financial instruments of the EU as an important part of the external policy of the Union which addresses the needs of less developed countries, and to demonstrate the interdependence between the ODA flows and some selected macroeconomic indicators of Ethiopia as one of the beneficiary countries of ODA.

In the first part of the paper, financial instruments of the EU development policy are brought into focus. We highlight the European Development Fund from which primarily the African countries, such as Ethiopia, are funded. We also look into the Development Cooperation Instrument which consists of both geographic and thematic format. Finally, the Instrument for Pre-Accession Assistance is analysed, and the components of which are destined for candidate countries for the EU accession and potential candidate countries.

In the second part of the article, through a visual analysis, we present the trend of ODA flows on the example of Ethiopia. In order to see the real development of all ODA flows into Ethiopia in the period of 1960-2011, the flows of EU members are added to the ODA flows of other world donors. By the correlation coefficient we will calculate the interdependence between the ODA flows into Ethiopia and the flows into all developing countries. The trend of flows is presented in figures too. The correlation analysis is applied to determine the interdependence between the aid to Ethiopia and selected macroeconomic indicators such as domestic product, gross national income, inflation, imports and exports of goods and services.

The coefficients of correlation are calculated and interpreted for the statistically available period of 1981-2011. We prove whether it is true that the more flows of ODA are allocated in a country the more its macroeconomic indicators do well. In the closing part, the findings are summarized.

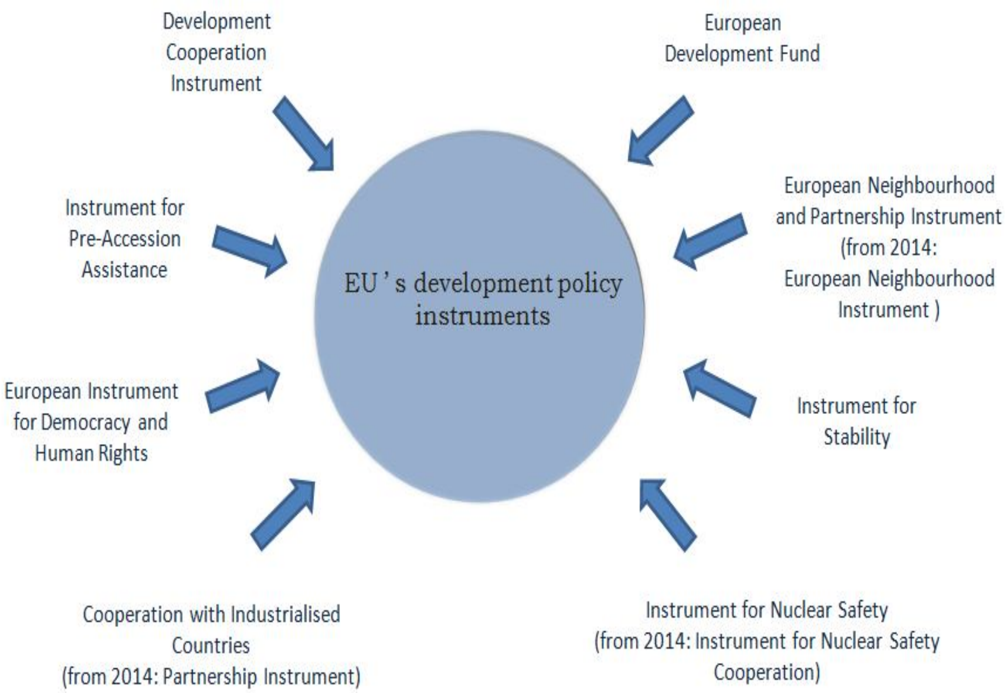
1. Financial Instruments of EU Development Policy

The EU holds a development portfolio in the form of several instruments of external policy. The EU development assistance is financed from two sources – the budget of the Union and that of the European Development Fund being not covered by the EU budget.

This special type of budget comprises voluntary contributions of the EU Member States, being the oldest and biggest EU development instrument. It finances primarily projects for African, Caribbean and Pacific States (ACP), and Overseas Countries and Territories (OCT) in order to promote economic, social and human development together with regional cooperation and integration. Other recipients financed from EU sources are represented by countries of Southern Mediterranean, Middle East/Gulf, Eastern Europe and Caucasus within the EU Neighbourhood policy, and also developing countries of Asia, Latin America and the Republic of South Africa. Project goals differ in respective regions. The objectives or areas of development activities funds are covered within financial instruments of development activities.

In the multiannual financial framework for 2007-2013, the Union simplified instruments of development policy in eight basic instruments for development. See them in Figure 1.

Figure 1 The EU's development policy instruments in multiannual financial framework 2007-2013



Source: Self-assembly according to the Website of the European Parliament (2013)

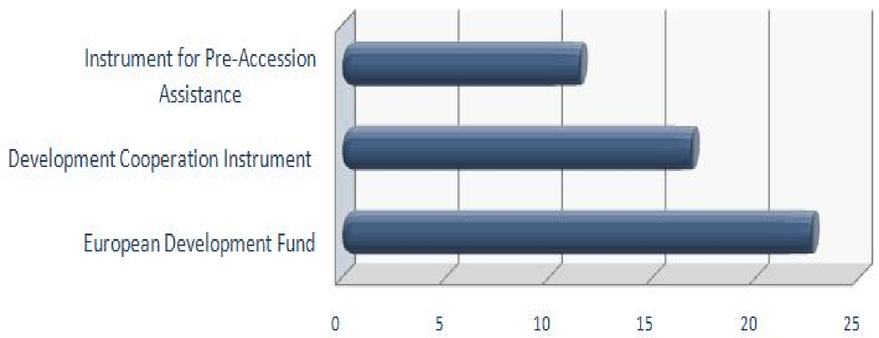
The EU Development Cooperation Instrument is the second biggest financial source after the European Development Fund. The instrument was released in January 2007, having replaced a range of geographic and thematic instruments previously available, enhancing thus the efficiency of EU development cooperation (European Commission, 2013). The Instrument for Pre-Accession Assistance represents another important instrument of EU development policy, and it focuses on accession or potential future accession countries into the EU. The Union is providing assistance through other instruments too, such as through the Instrument for Stability to promote political stability and peace-building; it is also through the European Instrument for Democracy and Human Rights destined for democracy and human rights' promotion.

Further it is Instrument for Nuclear Safety, Instrument for Cooperation with Industrialised Countries, and European Neighbourhood and Partnership Instrument, the latter of which seeks to support the goals of European neighbourhood policy.

In addition to the aforementioned instruments of EU development policy, the Union also provides humanitarian aid. The EU is amongst the main donors of humanitarian aid in the world. Humanitarian action and crisis response constitute a separate, non-development portfolio.

We look into the development portfolio of EU, especially into the financial instruments with the highest budget volume. The budgetisation of financial instruments respectively is shown in Figure 2.

Figure 2 Budget for financial instruments in multiannual financial framework 2007-2013



	European Development Fund	Development Cooperation Instrument	Instrument for Pre-Accession Assistance
In mld. EUR	22.7	16.9	11.5

Source: Self-assembly according to the Website of the European Parliament (2013)

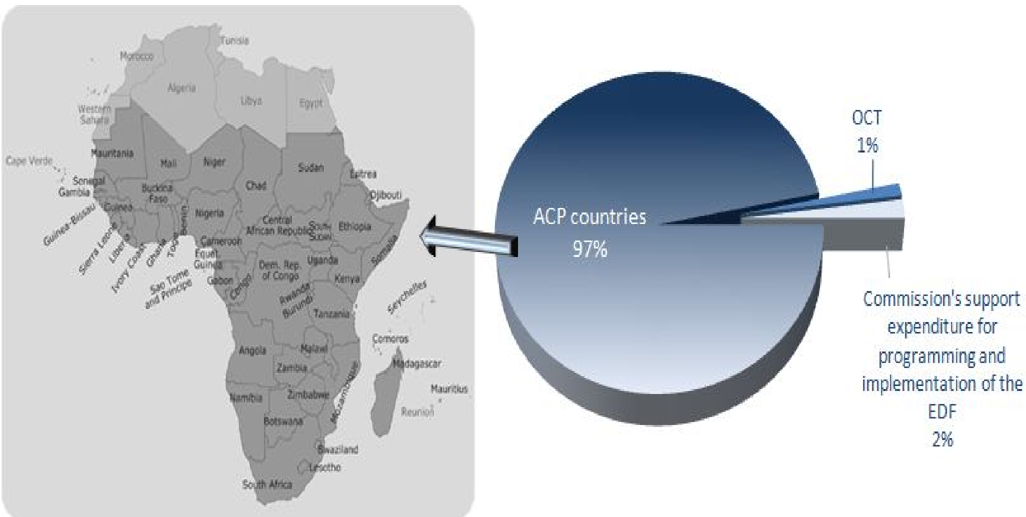
In the following section of the chapter, we focus on the three instruments of EU development policy, namely the European Development Fund, the Development Cooperation Instrument, and the Instrument for Pre-Accession Assistance.

1.1 European Development Fund

As outlined earlier, the primary assistance instrument of the Community for ACP and for the EU's OCT is represented by the European Development Fund (EDF). It was established in 1957 by the Treaty of Rome in order to provide technical and financial aid primarily to African countries, the colonies of some EU states at the time. The European Commission is in charge of the Fund management. The Fund is subject to its own financial rules and is managed by a specific committee. The main contributors are Germany, followed by France and Great Britain.

The Fund seeks to promote and enhance economic, cultural and social development, and also to contribute to peace and security as well as to foster stable and democratic political environment in recipient countries (Bonnet, Boni, 2007). The Fund finances 79 ACP and 21 OCT countries. As shown in Figure 3, funding of activities of ACP countries, mostly from Africa, is a priority to the Fund. As many as 49 African countries are financed.

Figure 3 Budgetary structure of the Fund in the multiannual financial framework 2007-2013



Source: Self-assembly based on data (Bonnet, Boni, 2007; Website of the European Commission, 2013)

One of the key priorities in ACP countries is the development of private sector and companies. The EU cannot solve all problems the ACP countries face; still through the volume of assistance, geopolitical influence, and primarily through cooperation instruments the Union can exercise, in terms of development, the so-called catalysing effect by means of applying efficient programs to strengthen the private sector (Sequeira Carvalho, 2000). Through EDF, business units of EU member states do also participate in developing projects, and in bringing in their respective know-how and technologies they are contributing to the economic and sectorial development in ACP countries. The project objectives are defined in the grant calls.

1.2 Development Cooperation Instrument

Within a given geographical boundary, the Development Cooperation Instrument (DCI) covers the development assistance to Latin America, Central, Eastern and South-Eastern Asia, the Middle East and South Africa. Through DCI, the Community assistance to these countries is aimed at supporting actions within the following areas of cooperation: (Summaries of EU, 2013)

- supporting the implementation of policies aimed at poverty eradication and at the achievement of the MDGs;
- addressing the essential needs of the population, in particular primary education and health;
- promoting social cohesion and employment;
- promoting governance, democracy, human rights and support for institutional reforms;
- assisting partner countries and regions in the areas of trade and regional integration;
- promoting sustainable development through environmental protection and sustainable management of natural resources;
- supporting sustainable integrated water resource management and fostering greater use of sustainable energy technologies;
- assistance in post-crisis situations and fragile States.

In addition to geographic programmes, the regulation provides finances also for global thematic programmes. The following five areas are covered: (Dudáš, 2007)

- investing in people;
- the environment and the sustainable management of natural resources;
- non-state actors and Local Authorities;
- the improvement of food security;
- cooperation in the area or migration and asylum.

Thematic programmes are complementary the geographic ones, and therefore they are meant for all developing countries (GIE, 2013).

1.3 Instrument for Pre-Accession Assistance

The EU following its development policy supports candidate countries and potential candidates to the Union accession. Through the Instrument for Pre-Accession Assistance (IPA), entities from present member states carry out projects in potential member states or their regions. This instrument is an important vehicle for a transfer of experience of EU Member States relating to the modernisation process and accession into the EU for candidate or potential candidate countries.

Figure 4 The IPA beneficiary countries

Source: Website of the European Commission (2013)

Countries funded from the IPA are divided according to the European Commission in the multiannual financial framework 2007-2013 into two categories:

- EU candidate countries (Croatia[3], Turkey and the former Yugoslav Republic of Macedonia)
- Potential candidate countries in the Western Balkans (Albania, Bosnia-Herzegovina, Montenegro, Serbia, and Kosovo under UN Security Council Resolution 1244/99)

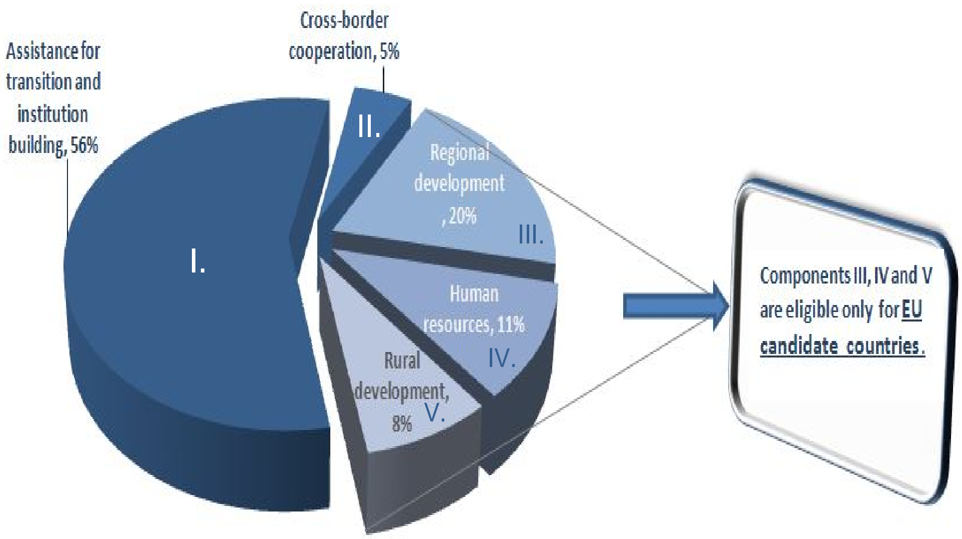
The IPA is made up of five different components:

1. Assistance for transition and institution building (assistance in establishing administrative and judicial capacity);
2. Cross-border cooperation– with EU Member States and other countries eligible for IPA (it also covers the participation of IPA beneficiaries in the European Research and Development Fund's trans-national and interregional co–operation programmes and in the European Neighbourhood and Partnership Instrument sea basins programmes);
3. Regional development (transport, environment, economic development);
4. Human resources (preparation of candidate countries using the European Social Fund under the European Employment Strategy);
5. Rural development (assistance with rural development programmes financed by the EU after accession).

EU candidate countries are eligible for funds under all five components of the IPA. Potential candidate countries are eligible only under the first two components of the instrument. Percentage of the IPA specific-components is illustrated in Figure 5. As shown in the figure below, funding for the component of 'Assistance for transition and institution building' makes up over half of the IPA instrument.

[3] From 2013 the EU Member State, no longer a candidate country.

Figure 5 Components of IPA in multiannual financial framework 2007-2013



Source: Self-assembly based on data (Bonnet, Boni, 2007; Website of the European Commission, 2013)

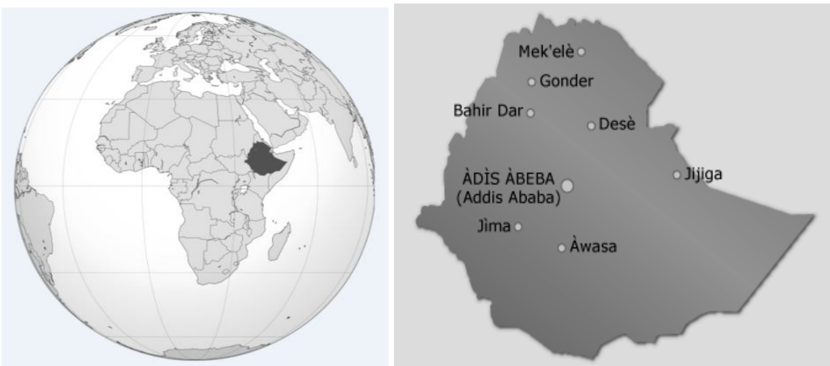
Hence we may assume that the first component in the form of the assistance in establishing administrative and judicial capacity and activities associated with the "acquis communautaire" are all a key aspect of the EU instrument for all IPA beneficiary countries including potential candidate countries. The second component of 'Cross-border cooperation' represents a minority share of 5% earmarked by the EU within IPA for EU candidate countries as well as potential candidate countries. Almost 40% of the IPA instrument are represented by the III., IV. and V. component available only for EU candidate countries. We see that the EU is focusing a special attention on these countries by means of the special components. The main objective is to prepare them for the programming, implementation and management of the Structural Funds and the Cohesion Fund after accession.

So far we have described the central parts of the EU development policy with its basic characteristics. In the following analytical part, on the example of a non-European country - Ethiopia, we present now more concrete impacts of the ODA and analyse them in comparison with some macroeconomic indicators in more general terms.

2. Ethiopia

The Federal Democratic Republic of Ethiopia is among the poorest countries in the world. Industry and infrastructure are underdeveloped, agriculture is not sufficiently modernized. Dry seasons alternate with rainy seasons in Ethiopia. In January and February occasional rains prevail; yet if insufficient, there is a risk of famines. Challenges of Ethiopia include food insecurity, a rapidly growing population, a small industrial base, environmental pressures exacerbated by climate change, etc. According to the European Commission (2013): *„The current EU cooperation strategy is designed to support the Ethiopian Government's efforts in achieving the MDGs through faster and sustained economic development, stressing regional integration and strengthening governance."* In the Horn of Africa, Ethiopia plays an important role in the perspective for regional stability and cooperation.

Figure 6 Ethiopia as a recipient country of ODA



Source: Website of the European Commission (2013) and Wikimedia Commons (2013)

Development assistance to Ethiopia showed an upward trend especially in the last decade. The Ethiopian economy is among the poorest in the world in spite of retaining a high economic growth in the last decade. Hence Ethiopia is using development aid to a great extent. The EU finances development aid primarily from EDF. However, Ethiopia accepts not only financial flows from EDF and voluntary contributions of the EU Member States but also from other donors in the world.

Figure 7 shows a trend in flows of the ODA from all donors in Ethiopia in approximately the last 50 years. The ceiling of the aid was reached in 2009 worth USD 3,181.83 million. These flows are compared with the flows in all developing countries from all donors in the same period. As we can see in Figure 7, the ODA flows to Ethiopia and to all developing countries show a very similar trend.

In the 1960s, the development assistance significantly started to rise in the time of large capital investments. It was a time of large investment programmes in which developed countries implemented verified procedures and strategies in under-developed countries. In the 1970s, an economic boom in the industry with oil and mineral resources started. *"Countries, lacking the potential, fell to lower-ranked groups whereas countries rich in energy and raw material resources were ranked significantly higher. Developing countries which retained their average positions had mostly been receiving foreign aid."* (Kuzmišin, 2008, p. 311). In the first half of the 1980s, the development assistance stagnated, and it began to grow strongly again towards the end of the decade. This slowdown came after the oil crises when a demand for loans of donor countries alone increased when they were in need of funds for their structural reforms. They alone did not have the necessary financial resources, and therefore they enhanced development assistance only to the end of the 1980s, as shown in Figure 7.

The relation between the ODA to all beneficiary countries and to Ethiopia can be examined through the correlation coefficient.

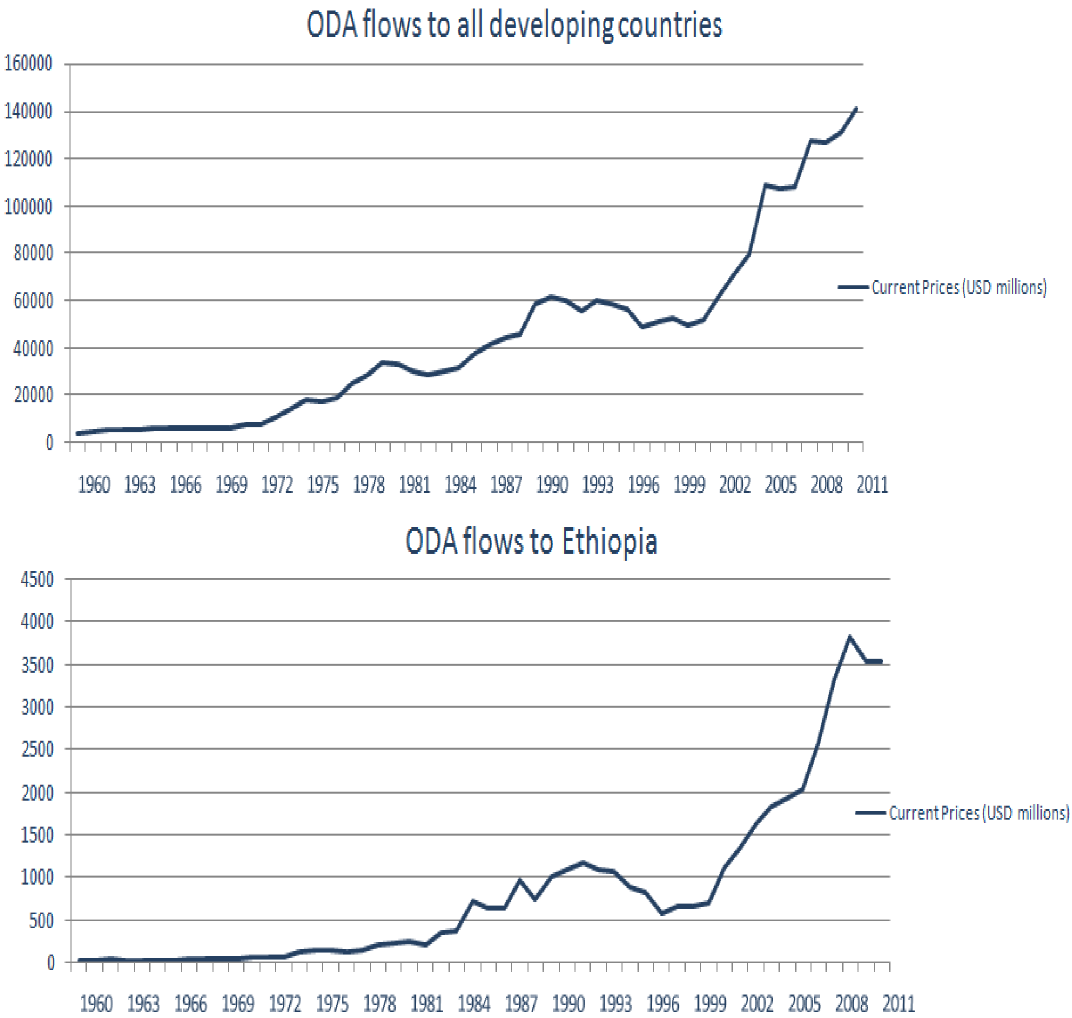
To present this mutual relationship of parameters analysed, the Pearson coefficient of correlation has been applied, counted as follows: (Rodgers and Nicewander, 1988)

$$r = \frac{\sum_{i=1}^{n}\left(X_i - \overline{X}\right)\left(Y_i - \overline{Y}\right)}{\sqrt{\sum_{i=1}^{n}\left(X_i - \overline{X}\right)^2}\sqrt{\sum_{i=1}^{n}\left(Y_i - \overline{Y}\right)^2}},$$

Where X and Y are represented by parameters, the i by individual observations and n by the number of observations.

Having applied the formula for the period of 1960 – 2011, we get the value of the correlation coefficient at 0.966197. Hence we can say that there is a very strong dependence between the flows to Ethiopia and all other ODA beneficiaries. The situation may be interpreted as the fact that, the higher world flows increase to all recipient countries, the more to Ethiopia too.

Figure 7 ODA flows to all recipient countries and to Ethiopia alone



Source: Self-assembly based on data of OECD / DAC

In order to see the interdependence between the ODA flows to Ethiopia and respective macroeconomic indicators, we are examining it also through calculations of correlation coefficients.

To analyse the relation between the ODA flows and respective macroeconomic indicators we apply then the correlation analysis. To get a complex view of the relation between selected macroeconomic indicators of Ethiopia and the ODA to the country, it is still necessary to add all other financial flows from other donors to the ODA of the EU. When counting respective correlation coefficients we draw on data of indicators of the World Bank Group and the International Development Statistics of the OECD.

Table 1 shows the relationship between world flows of the ODA to the Ethiopia on one hand, together with the macroeconomic indicators such as gross domestic product (GDP), gross national income (GNI), inflation, imports and exports of goods and services, on the other. The correlation analysis has been carried out based on the statistical data available for 1981-2011[4].

Tab. 1 Relationship between the ODA flows and selected macroeconomic indicators in Ethiopia

Indicator	Correlation coefficient
GDP (current US$)	0.925829
GNI (current US$)	0.925698
Inflation, GDP deflator (annual %)	0.555128
Exports of goods and services (% of GDP)	0.561003
Imports of goods and services (% of GDP)	0.739725

Source: self-calculations based on data from WBG and OECD

There is very strong positive relationship between the flows of the official development assistance with the GDP indicator, which means that the ODA markedly and positively contributes to the GDP growth in Ethiopia.

[4]An exception is the correlation coefficient between the inflation and the world's ODA counted for the period of 1982-2011 since the value of indicator of inflation is not available in the database of the World Bank Group before 1982.

It is similar with the GNI. The correlation coefficient also represents a very strong relationship, so increasing volume of assistance positively influences the increase in the national income. Financial inflows within the ODA to Ethiopia may, to a certain extent, decrease the value of money. The correlation coefficient value of the inflation to the ODA can be viewed as strongly correlated. As for the export indicator and development assistance, we may see the values as strongly correlated. Between the imports and the ODA, there is a very strong correlation which might also be interpreted as a state where there is more money available in the country enabling it to import more too.

We are aware of the limits of the methodology applied as some structural aspects of the Ethiopian economy might be researched further and more in detail, together with other fundamentals affecting the exports, imports, or inflation of this landlocked African country ranking among the poorest in the world. On the other hand, it is the extremes, while applying the method of abstracting from other factors, that pose a challenge to meet in studying the effects of external forces, influences and (positive) interventions in the economies like Ethiopia in that these external actions have all the higher impact on the macroeconomic indicators of the country, as proved by significant values of the interdependence calculated.

3. Conclusion

The amount of financial resources allocated for development assistance is not the goal but rather means to reach an objective – improvement of socio-economic situation of people in a country. The EU, since its creation, has promoted development of less developed regions. The Union gradually extended the original scope of focus on the ACP countries, cooperating today with developing countries across the world. The EU is the largest world donor in term of development assistance, with several development financial instruments available. Financial resources for development are allocated primarily in the EDF, DCI and IPA. The EDF is the biggest source of finance for development policy, covering particularly development activities in ACP countries. The second largest source of finance for development activities is the DCI through which the EU finances measures aimed at supporting geographic cooperation with the developing countries included in the list of aid recipients of the DAC of OECD.

With the IPA instrument, the EU focuses its development activities on candidate countries for the EU accession and potential candidate countries. Candidate countries are eligible for funds under all five components of the IPA whereas potential candidates are eligible for aid only under the first two components of the instrument.

Based on the assistance volume to Ethiopia in time, considering developments of GDP, GNI and exports or imports, we can see a strong positive correlation of the parameters. The more efficient assistance is directed to Ethiopia, the more beneficial impacts it should have for its economy. However, general conclusions might be drawn after analysing similar relationships with other ODA beneficiaries and with more macroeconomic indicators, which is an appropriate subject for further scientific and research activities. The African countries, on account of historic, political or climatic or other factors, represent a special world group of the ODA beneficiaries. These specific characteristics, including Ethiopia, require a more thorough analysis, either in the light of researching into factors within the economy alone or in the form of benchmarking methods of the ODA implications in similar African countries.

The mechanism process of the official development assistance requires a dynamic and open approach in the fast-changing socio-political environment. Much higher priority needs to be given to the development policy alone, but also to ODA recipient countries, considering their economic, political and social conditions, helping them reduce poverty in order to foster sustainable development.

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