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Scientific or political?

Options for the 11th European Development Fund allocation method

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Abstract

With six months left before the deadline, the European Union (EU) is still negotiating both its multi-annual budget for 2014-2020 and the successor to the 10th European Development Fund (EDF), i.e. the 11th EDF for 2014-2020. The European Commission (EC) has indicated that it intends to further strengthen the focus of the EDF on the poorest countries. It has, however, revealed few details of how it intends to do this. This background paper explores the possible approaches that the EC could take to determine 11th EDF aid allocations; their respective implications for the future of development cooperation with the African, Caribbean and Pacific group; and the changing levels of development assistance to high-income and upper-middle-income countries, more commonly referred to as differentiation.

The new EDF aid allocation model is likely to be based on a number of criteria, which meet both traditional and recent EU policy trends and requirements. The technical process of constructing the model, however, offers a variety of methodological tools and options for adjustments and modifications, which leaves considerable leeway for particular allocation outcomes to be achieved. Any scientific, objective model may therefore still accommodate subjective judgments and political interests.

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The views presented in this paper are those of the author alone.

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Abbreviations

Abbreviation	Description
ACP	African, Caribbean and Pacific
CPIA	Country Policy and Institutional Assessment
DRC	Democratic Republic of Congo
EC	European Commission
EDF	European Development Fund
EPI	Environmental Performance Index
EU	European Union
EVI	Economic Vulnerability Index
GNI	Gross national income
HAI	Human Asset Index
HDI	Human Development Index
HIC	High-income country
LDC	Least-developed country
LIC	Low-income country
MIC	Middle-income country
MPI	Multidimensional Poverty Index
OLIC	Other low-income country
UMIC	Upper-middle-income country
UN	United Nations
UNDESA	United Nations Department of Economic and Social Affairs
WGI	World Governance Indicators

1 Background

The European Development Fund (EDF) is the main instrument for delivering European Union (EU) development aid to the 78 African, Caribbean and Pacific (ACP) states. It is governed by the ACP–EU Cotonou Partnership Agreement, which is the largest and most advanced existing financial and political contractual framework for North–South cooperation (Gavas, 2013). This agreement establishes joint development objectives and efforts; joint parliamentary oversight structures; joint ministerial meetings; and joint reporting among ACP states, EU member states and the European Commission (EC).

Although not part of the EU budget, the 11th EDF will cover the same time period (2014-2020)[1] and discussions on its replenishment are running in parallel to discussions on the new EU budget. The EDF is funded and managed on the basis of an intergovernmental agreement of EU member states and their specific contribution shares or 'keys', which are agreed at the beginning of each new EDF funding period. The largest contributors (traditionally France, Germany and the United Kingdom) hold most of the votes in the EDF Committee, making them the most influential member states. The European Parliament has limited powers in relation to the EDF: it merely grants the discharge of the funds (Gavas, 2012).

EU funding to ACP countries under the EDF is considered part of its official development assistance contribution.[2] The budget of the current 10th EDF amounts to €22.68 billion, which represents about 30% of EU spending on development cooperation, with the remainder coming directly from the EU budget (Gavas, 2012). While the EC initially proposed a €34.28 billion EDF in current prices[3] for the period 2014-2020, the member states agreed an amount of €30.51 billion in current prices. Although in absolute terms this is still higher than the preceding 10th EDF budget, the fund has been effectively frozen at 2011 levels. And even though negotiations around the levels of funding for ACP–EU cooperation for the next seven years are already coming to a close, little is known about the design and outcome of the aid allocation model of the new EDF.

EU aid to ACP countries under the 10th EDF was allocated according to an elaborate and complex allocation model that combined both quantitative criteria and qualitative assessments. Apart from a wide-ranging set of needs and performance indicators, it comprised a selection of vulnerability indicators and investment climate criteria. Many of the indices were assigned non-linear weights along with various cappings of upper and lower limits. In addition, the 9th EDF allocations were also incorporated as an indicator in the formula – 50% of a country's allocation under the 10th EDF comprised its respective allocation under the 9th EDF (EC, 2007). The resulting aid distribution across income

[1] The proposed 11th EDF covers a different number of years compared to its predecessors (EDF 11: seven years; EDF 10: six years; EDF 9: eight years; EDF 8: five years). The one-year extension of the 11th EDF compared to the 10th EDF allows the end of the 11th EDF to coincide with the end of the period covered by the Cotonou Partnership Agreement in 2020, as well as that of the next EU budget.
[2] Excluding allocations to the African Peace Facility.
[3] €30.32 billion in 2011 prices.

groups (see Table 1) highlights the strong poverty focus of the 10th EDF. About 80% of geographic allocations (envelope A of the EDF) was directed to least-developed countries (LDCs) and other low-income countries (OLICs) (compared to 77% under the 9th EDF). Furthermore, the shares allocated to high-income countries (HICs) and upper-middle-income countries (UMICs) decreased by 25% and 29%, respectively, while the share of the 10th EDF allocated to LDCs increased by 9%.[4] This suggests that, due to the priority given to needs, differentiation is already a well-established principle and a continuing trend in EDF allocations.

Table 1: EDF allocation distributions over income groups

	9th EDF allocation (€ m.)	% of total	10th EDF allocation (€ m.)	% of total	% increase in share of total EDF (% of EDF 9 > % of EDF 10)
LDCs	4,883.7	69	9,644.1	75	9
OLICs	576.0	8	513.0	4	-50
LMICs*	1,098.9	15	1,942.5	15	0
UMICs	508.2	7	637.8	5	-29
HICs	27.4	0.4	40.0	0.3	-25
Total	7,094.2		12,777.4		

* Lower-middle-income countries.

Source: European Commission data

[4] An analysis of the allocations to the respective income groups as shares of the overall EDF amount is preferred, as opposed to comparing the change in absolute amounts, since the overall amounts of the 9th and 10th EDFs are different and countries may have changed income groups in the period between the two funds.

2 Criteria

Governed as it is by the Cotonou Agreement and seeking to implement the new policy orientations defined by the Agenda for Change (EC, 2011), the EDF is situated in a complex institutional framework. While Article 3 of Annex IV of the Cotonou Agreement stipulates that EU development assistance to ACP countries will be allocated according to 'standard, objective and transparent needs and performance criteria', the Agenda for Change proposes a model incorporating three additional factors, i.e. capacity (the ability to generate and access sufficient financial resources, absorption capacity, etc.), commitment (investment in education, health and social protection; soundness of economic and fiscal policies, etc.) and potential EU impact (the potential of EU cooperation to support policy reforms and leverage other sources of development finance).

A number of indicators meet these conditions and are thus likely to be used for the construction of the 11th EDF allocation model.

2.1 Country population

Population is commonly used as a foundation for aid allocation formulas because it serves as a tool to determine the scope of any other indicator. A larger population size would therefore indicate a higher level of needs. However, depending on its assigned weight, this indicator can exert a powerful influence on the allocation outcomes. From Nigeria's 162 million to Niue's just over 1,000 inhabitants, ACP countries have a vast range of population sizes – over one third of ACP countries have a population of under a million, another third between 1 and 10 million, and only five countries have a population of over 40 million. This strong variability is likely to result in significant amounts of aid being concentrated in the larger and most populous countries (Nigeria, Ethiopia, the Democratic Republic of Congo (DRC), Tanzania and Kenya) at the expense of the smaller ones, which represent over 40% of all countries in the ACP group. Therefore, this effect is likely to be moderated and corrected by applying weights and/or caps to the population indicator in order to change the resulting distribution. For example, by applying exponentiation (putting population to the power of an integer between 0.5 and 0.9), the effect of the index becomes less and less strong as the population size becomes bigger; in other words, population would be a stronger indicator for Gambia, with a population of 1.7 million, than for Ethiopia, with a population of 84.7 million.

2.2 Needs

Income measured in gross national income (GNI) per capita is a logical indicator of the economic dimension of country needs. However, in order to avoid a purely one-dimensional focus, GNI is likely to be complemented by an index like the Human Development Index

(HDI), the Human Asset Index (HAI) or the Multidimensional Poverty Index (MPI), which would capture the social and human development dimensions of country needs.

The three indices focus on identical social trends – i.e. health, education and living standards – and provide a similar perspective on the state of human development of countries. However, they differ in composition and computational methods: while the HDI measures mean and expected years of schooling, the HAI looks at school enrolment ratios and the MPI considers both; and while the HDI considers life expectancy at birth, the MPI and HAI incorporate infant mortality rates. Furthermore, the HDI features GNI as one of its components, which would present challenges if the human development indicator is to be incorporated in a formula already containing an income criterion.[5] Finally, while both the MPI and HDI are more 'input oriented', taking stock of opportunities, capabilities and deprivations, the HAI is more 'output oriented', focusing on outcomes and results with respect to the state of human capital.

The United Nations Department of Economic and Social Affairs (UNDESA)-devised HAI index is likely to be particularly well suited to inform aid allocation decisions, since it is used to determine the LDC category, alongside GNI per capita and the Economic Vulnerability Index (EVI) (see below). These three indicators are therefore likely to be important additions to the EDF allocation formula, providing not only a more holistic representation of country needs, but also tipping the scale in favour of LICs.

2.3 Performance

Performance can be a rather ambiguous concept, referring either to the quality of results obtained from policy or to the quality of policy itself. Well-performing countries are rewarded through higher allocations based on the premise that good governance and sound policies are likely to enhance aid effectiveness (Court, 2006). Contrary to the needs domain, where a high national income and a more advanced level of human development would indicate a lower need for development assistance, good performance in the field of governance would entail a higher allocation.

Measuring performance would require taking into account the various aspects of a country's governance: from democracy, human rights and the rule of law to the soundness of its domestic economic, social and fiscal policies and the state of public finance management. Progress in these fields can be quantified using either a composite indicator of governance (such as the World Bank index for Country Policy and Institutional Assessment – CPIA) or a selection of several relevant indicators (e.g. the six World Governance Indicators (WGI), the World Bank Cost of Doing Business, the Corruption Perception Index, etc.). In contrast to the shared focus of the HAI and HDI, governance indicators do not appear to be significantly correlated. This implies that the distribution of funds among ACP countries would vary significantly depending on the measure of governance used in the allocation method.

2.4 Capacity, commitment and potential impact

Both country capacity and commitment are dimensions that cannot be effectively captured by a single targeted indicator. This means that in order to include these two dimensions in the allocation formula the EC would most probably have to resort to its own absorption capacity indicators and internally produced measurements and assessments of country

[5] See http://www.un.org/en/development/desa/policy/cdp/ldc/ldc_criteria.shtml; http://hdr.undp.org/en/statistics/hdi/; http://www.ophi.org.uk/multidimensional-poverty-index/mpi-data-bank/

commitment. This, however, would represent a significant departure from the policy requirement to use 'standard, objective and transparent' criteria and might fuel discussions about the impartiality of such methodology. Furthermore, the policy imperative to acknowledge impact and commitment, paired with the lack of appropriately targeted indicators, gives the EC potential leeway to apply ad-hoc adjustments to the model outcomes and augment resulting allocations according to subjective country assessments.

2.5 Vulnerability and fragility

Vulnerability can be broadly defined as the extent to which a country is susceptible to exogenous shocks, where a distinction can be made between the country's exposure to shocks and its capacity to cope with them (resilience). The occurrence of shocks, both environmental and economic, tend to generate economic instability, and hamper growth and aid effectiveness (Makoka and Kaplan, 2005). The concept is high on the EU development agenda and figures among the priority areas of many member states, making it a pertinent factor to be considered in the aid allocation process.

An indicator such as the EVI, the Environmental Performance Index (EPI) or the Environmental Vulnerability Index is therefore likely to assume a place in the EDF allocation formula. The LDC-defining Environmental Vulnerability Index is particularly interesting since it considers both environmental and economic aspects of country resilience and exposure to exogenous shocks.[6] Applied to the ACP states, this indicator is likely to particularly favour the small island states in the Caribbean and Pacific. The index prioritises factors like remoteness, the occurrence of natural disasters and export-sector concentration, which capture the traditional weaknesses of small island states. More environment-targeted indicators, such as the EPI and the Environmental Vulnerability Index, present interesting alternatives, although their composition points towards similar allocation outcomes.

While commonly considered to be a similar concept, fragility is distinctly different from vulnerability. State fragility is an endogenous concept pertaining to internal institutional and policy weaknesses, whereas vulnerability refers to a country's exposure to exogenous shocks and uncertainties. The latter, however, is likely to significantly influence the former, indicating that many LDCs are also fragile states, although the two do not necessarily overlap (Béné et al., 2012). The most commonly used reference point for determining whether states are fragile or not is the World Bank's list of fragile and conflict-affected countries and situations.

[6] See http://www.un.org/en/development/desa/policy/cdp/ldc/ldc_criteria.shtml

3 Allocation formula

Given the level of complexity of the allocation formula used for the replenishment of the 10th EDF (featuring criteria such as population and population density, income per capita, relative share of young population, a modified UN Development Programme poverty index, the prevalence of HIV/AIDS, geographical location, and investment climate criteria), the overall methodology was complex, carried over an inheritance from the 9th EDF and proved challenging for various stakeholders to interpret.

With clear policy directives in place, greater calls for transparency, abundant stakeholder interest and a changing development agenda, the EC may be dissuaded from pursuing similar levels of complexity in the 11th EDF. Indicators are likely to be few, carefully selected, targeted and incorporated in a fairly straightforward formula, most likely with no reference to previous allocation methods. Incorporating the indicators elaborated above, the allocation formula:

- could be as simple as:

Population$^{\sim 0.5\text{-}0.9}$ x needs indicator x governance indicator x human development indicator x vulnerability indicator.

- Alternatively, the formula could incorporate assigned weights to the priority indicators for the EC:

Population$^{\sim 0.5\text{-}0.9}$ x (weight) needs indicator x (weight) governance indicator x (weight) human development indicator x (weight) vulnerability indicator.

The size and application of arbitrary weights to the allocation formula are likely to reflect recent EU development priorities and trends. The objectives and priorities for EU development assistance as laid out in the Agenda for Change, such as strong commitment to Millennium Development Goal progress, poverty eradication and sustainable growth for human development, are therefore likely to translate into an allocation formula with a strong needs focus. The human development indicators are likely to assume a particularly prominent position should a weight option be used, thus favouring allocations to LDCs and OLICs and contributing to a more differentiated treatment of ACP countries. A subject equally prominent in the current development agenda, however – that of economic and climate change vulnerability – is likely to have the opposite effect on country aid allocations by favouring small islands states. Further still, the performance and governance focus is likely to champion yet another group of ACP countries if it is incorporated into the 11th EDF allocation methodology.

These diverging trends of allocation priorities can produce a number of outcomes depending on the allocation methodology and the relative priority they are given.

4 Contending trends

4.1 Combined effect of economic needs and human development needs

Following the traditional poverty focus of EU development policy, the Agenda for Change gives pride of place to poverty reduction. Resources are to be concentrated where they are most needed, implying that the needs dimension is likely to assume a prime place in the EDF allocation formula. Both income and human development criteria are likely to favour the poorest and most disadvantaged ACP countries. Even though there are some differences in ranking (due to the different focus of the indices), the three needs indicators do paint a similar picture as far as the distribution of needs among ACP countries is concerned. UMICs and HICs in the Caribbean and Pacific are at one end of the spectrum, while LICs and LDCs in sub-Saharan Africa are at the other (see Table 2) and are bound to receive more generous allocations under a needs-driven allocation formula. Notable exceptions are Angola and Equatorial Guinea, which, although classified by the World Bank as a UMIC and HIC, respectively, have below-average levels of human development and thus have been granted LDC status by the UN Economic and Social Council. The opposite trend can be observed with countries like Madagascar, Uganda and Rwanda, which have low levels of income per capita, but relatively higher human development scores (compared to other LDCs and OLICs).

Table 2: Needs 'winners' and 'losers': rankings* according to GNI per capita and non-income HDI

GNI rank p/c**	Lowest-ranking: bottom 25% ACP countries (HDI rank)	GNI rank p/c	Highest-ranking: top 25% ACP countries (HDI rank)
78	DRC (69)	1	Bahamas (9)
77	Somalia (N/A)	2	Trinidad and Tobago (17)
76	Liberia (49)	3	Equatorial Guinea (53)
75	Burundi (66)	4	St. Kitts and Nevis (15)
74	Malawi (51)	5	Barbados (1)

73	Sierra Leone (71)	6	Antigua and Barbuda (10)
72	Niger (78)	7	Seychelles (4)
71	Ethiopia (65)	8	Mauritius (16)
70	Eritrea (67)	9	Gabon (24)
69	Madagascar (35)	10	Suriname (20)
68	Guinea (64)	11	Botswana (29)
67	Central African Republic (70)	12	Palau (2)
66	Mozambique (76)	13	Grenada (3)
65	Uganda (48)	14	Dominica (11)
64	Tanzania (44)	15	St. Lucia (12)
63	Togo (43)	16	St. Vincent and the Grenadines (13)
62	Burkina Faso (75)	17	Dominican Republic (18)
61	Rwanda (56)	18	Tuvalu (N/A)
60	Guinea-Bissau (72)	19	Jamaica (8)
59	Mali (74)	20	Namibia (27)

* A country's rank for a particular indicator is defined according to its score relative to the 78 ACP countries.
** Per capita.
Source: Author's own construct using World Bank and UNDP data

It is important to note that about a third of all ACP countries have a GNI per capita below $1,000 and 52 out of 78 ACP countries have a GNI per capita below the group average of $3,600. This means that while a distinct needs focus would favour these countries, the effect of this policy choice will be spread across a large number of countries that meet the criteria: about two thirds of all ACP countries.

4.2 Performance vs needs

The Agenda for Change does not stop at the prescription of poverty eradication: resources are to be targeted not only where needs are highest, but also where the potential impact would be most significant. While it is difficult to assess what the preconditions are for aid to stimulate development, it is generally believed that good governance and a solid policy and institutional framework could ensure national ownership of development programmes and contribute to aid effectiveness (Booth, 2011). However, depending on how performance in the field of good governance is represented in the model, the high-scoring good-governance champions among the ACP countries are not likely to be among the ones with the highest needs. In terms of allocation levels, a performance focus is likely to favour countries with a record of good governance mostly in the Caribbean and Pacific and a few traditional African development policy champions (some of them middle-income countries – MICs)

such as Botswana, Namibia, Ghana and Ethiopia. On the other hand, likely to lose out because of their poor performance scores are countries such as the DRC, Somalia, South Sudan, the Central African Republic and Zimbabwe – countries that also concentrate the highest levels of needs (see Table 3).

This clash between trends means that any allocation formula aiming to consider both needs and performance would have to either balance their conflicting impacts or tip the scale in favour of one option.

Table 3: Top- and bottom-performing countries according to WGI ranking

Rank	Top performers (top 15%)	Average WGI, 2011	Rank	Bottom performers (bottom 15%)	Average WGI, 2011
1	Barbados	1.23	78	Somalia	-2.30
2	Bahamas	0.92	77	DRC	-1.64
3	St. Lucia	0.90	76	Sudan	-1.60
4	St. Kitts and Nevis	0.87	75	South Sudan	-1.48
5	St. Vincent and the Grenadines	0.85	74	Zimbabwe	-1.48
6	Antigua and Barbuda	0.81	73	Eritrea	-1.40
7	Mauritius	0.78	72	Central African Republic	-1.30
8	Dominica	0.74	71	Chad	-1.30
9	Botswana	0.69	70	Equatorial Guinea	-1.27
10	Cape Verde	0.52	69	Guinea	-1.19
11	Grenada	0.38	68	Burundi	-1.19
12	Namibia	0.30	67	Haiti	-1.16

Source: Author's own construct using World Bank WGI database averaged data

4.3 Taking stock of vulnerability

Policy decisions and outcomes are often influenced by various shocks that can structurally weaken a country's institutional settings (Makoka and Kaplan, 2005). Therefore, in order to propose a genuinely performance-based allocation of the 11th EDF resources, the EC is likely to take stock of the vulnerability, exposure and resilience of ACP countries to

exogenous shocks. A vulnerability indicator such as UNDESA's EVI would prescribe more resources to small island states in the Caribbean and Pacific and other countries abundant in the economic and environmental challenges registered by the indicator (remoteness, agricultural and export instability, natural disaster recurrence, etc.). While a relevant criterion aimed at increasing aid effectiveness and capturing relevant factors for development, the vulnerability indicator could potentially introduce further fluctuations in the results of the aid allocation model. Most countries that are considered to be vulnerable are LDCs, which are already likely to receive high allocations in response to their needs. However, among the countries with high EVI scores are some of the ACP UMICs, which are already likely to be rewarded for their good-governance and policy performance (but disadvantaged for their high income and human development scores) (see Table 4). Suriname, St. Kitts and Nevis, Grenada, Seychelles, Antigua and Barbuda, and Dominica are UMICs with particularly high EVI scores.

Table 4: Most and least vulnerable countries according to EVI ranking

Rank	Most vulnerable (top 15%)	EVI, 2012 (1–100)	Rank	Least vulnerable (bottom 15%)	EVI, 2012 (1–100)
1	Kiribati	81.99	78	Côte d'Ivoire	20.90
2	Suriname	70.32	77	Cameroon	23.35
3	Gambia	67.79	76	Dominican Republic	24.48
4	Tuvalu	63.93	75	Kenya	26.57
5	Liberia	60.97	74	Guinea	28.60
6	Guinea-Bissau	60.52	73	Ghana	28.65
7	Tonga	59.63	72	Tanzania	28.69
8	Eritrea	58.99	71	Barbados	29.35
9	Burundi	57.16	70	Mauritius	29.78
10	Solomon Island	55.25	69	Gabon	32.98
11	Timor-Leste	53.35	68	Ethiopia	33.48
12	Zambia	53.03	67	Jamaica	33.51

Source: Author's own construct using UNDESA data

5 Implications for ACP countries

An all-encompassing EDF allocation formula would try and incorporate all relevant policy considerations, recent trends and EU development priorities. However, as seen above, these may cancel each other out within the allocation formula or, indeed, make the final outcome of the allocation distribution very volatile. This is not only due to the fact that the indicators focus on different and sometimes-conflicting trends, but also because the ACP group comprises countries with diverse characteristics and at different stages of their social and economic development. A few country cases illustrate this issue:

- **Angola** has a high level of income per capita, indicating the need for a lower allocation. On the other hand, its large population size combined with a low level of human development would prescribe a large allocation, while its average governance performance and commitment, and moderate vulnerability are likely to introduce yet another axis of contention.
- **Equatorial Guinea** has a small population, a high level of income per capita and a low governance score, which point towards a small allocation; however, if multidimensional needs are considered, the country's below-average score would provide a countering trend towards a higher allocation.
- **Somalia** and **Haiti** present yet another model of indicator divergence. Although not among the most-populated countries in the ACP group, both countries have a relatively large population. Combined with a very low level of income per capita and a very low level of human development, the distinct needs gap would require a high allocation. However, both Somalia and Haiti have a very low score on governance and their overall allocations could be reduced based on poor performance.
- In the case of **Zimbabwe** and **South Sudan**, these countries' large populations in combination with their low income levels would push for a higher allocation. The level of human development of both countries, however, is above average and likely to counter the positive trend and reduce the allocation. Furthermore, both countries are poor performers in terms of governance and hence are likely to see their allocations reduced even further by the formula.

Table 5: Selected country data

Country	Population 2011 (m.)	GNI p/c*, 2011 ($ at current prices)	HAI, 2012 (1–100)	Non-income HDI, 2011 (0–1)	MPI, 2012 (0–1)	EVI, 2012 (1–100)	WGI, 2011 (from -2.5 to +2.5)
Angola	19.618	3,830	31.6	0.48	–	51.29	-1.06
Equatorial Guinea	0.720	15,670	43.0	0.46	–	43.69	-1.27
Haiti	10.124	700	35.6	0.52	0.29	47.31	-1.16
Somalia	9.557	216	1.4	–	0.51	50.10	-2.30
South Sudan	10.314	984	52.6	–	–	44.44	-1.48
Zimbabwe	12.754	660	57.7	0.45	0.17	44.90	-1.48

* Per capita.

Source: Author's own construct using World Bank, UNDESA, UNDP and OPHI data

Some of the issues that arise due to such contending trends in the allocation criteria can be resolved through applying methodological modifications to the model and the data. For example, ceilings and caps can be introduced in order to moderate the effect of some indices on the allocation outcomes for the countries with the highest or lowest values. Furthermore, indices can be standardised, presented in a logarithmic value or assigned an array of different weights. In fact, as far as econometric modelling is concerned, numerous mathematical and statistical approaches can be applied for a number of practical reasons.

While many of those adjustments and modifications can be justified on account of their methodological necessity, they also make it possible to use the same model structure with the same indices and using the same data, but to reach different distributional outcomes. This range of methodological options leaves considerable leeway for the EC to be able to achieve certain desired outcomes through purely quantitative means.

In fact, recent studies on the process of aid allocation suggest that the allocations of multilateral donors in general and the EU in particular are interest driven; in other words, aid allocation is often subject to vested national and political interests. Conflict states and countries of particular geostrategic interest to the EU, for example, often receive a disproportionately large share of official development assistance (AidWatch, 2012; Bigsten, Plateau and Tengstam 2011; Oxfam, 2011). Therefore, donor interests are effectively another criterion for aid allocation, which can potentially be incorporated through methodological model and data adjustments. What is essentially an objective and straightforward tool for allocating EDF funds to ACP countries lends itself to various methodological treatments, implying that the final outcome of any model becomes significantly dependent on the discretion of decision-makers.

Thus, even if an allocation model is based exclusively on 'standard, objective and transparent' criteria it may still accommodate subjective judgements and political interests regarding the volume and distribution of country allocations.

6 Implications for differentiation

As the distribution of the 9th and 10th EDF budgets across income groups shows, there has already been a considerable targeting of aid towards LDCs and OLICs in past allocations (see Table 1). While not a new concept, differentiation features prominently in the Agenda for Change and has gained considerable popularity since the introduction of the policy document in 2011. It is essentially a policy aiming to adjust EU development assistance to the changing global poverty distribution patterns by recognising the diverging needs of developing countries and concentrating development cooperation in LDCs (while remaining committed to supporting poverty reduction and other development objectives in MICs). The Development Cooperation Instrument will be the first to apply the policy of differentiation both in terms of eligibility and volumes of development assistance. However, the EC has indicated that while differentiated eligibility for development assistance (i.e. graduation) will not apply to the 11th EDF, it plans to propose an increased differentiation of aid volumes (Herbert, 2012; Keijzer et al., 2012).

As far as the allocation model is concerned, it would be logical for the EC to present differentiation as the natural outcome of the allocation methodology – especially given the strong poverty focus of the policy directives of the Agenda for Change. This would mean that differentiation within the EDF would be presented as objectively achieved rather than politically decided, which would prevent many potentially heated discussions within the EU and between the EU and the ACP group of states.

However – and given the nature of some of the indicators that could be used (e.g. accounting for vulnerability or rewarding good governance) – it is also likely that the model would reward some UMICs more than the EC would deem reasonable in the context of differentiation. In this case amendments could be introduced into the methodology (such as giving a larger weight to the needs criteria) or an altogether separate system for differentiation could be devised.

Finally, even though there are 21 UMICs and HICs within the ACP group that qualify as potential differentiation candidates (if a purely income criterion is applied), the amount of resources likely to be gained by applying differentiation to the EDF is hardly significant: an estimated €1 billion or around 5.3%[7] of the discussed 11th EDF amount. These countries already receive rather small shares of EU development assistance due to their small population sizes and the traditionally prominent poverty focus of EU development policy.

[7] This estimation is based on the share allocated to UMICs (5%) and HICs (0.3%) under the 10th EDF (see Table 1) applied to the estimated 11th EDF amount for National Indicative Programme allocations.

7 Conclusion and likely options

This working paper has briefly reviewed likely options for the construction of an aid allocation model for the 11th EDF, reviewing the possible choice of indicators and formulas, as well as likely outcomes in terms of aid distribution and differentiation patterns among ACP countries. It has focused on five criteria that meet the EC's policy requirements, i.e. population, income per capita, a measure of human development (such as the HDI, HAI, MPI, etc.), a measure of vulnerability (such as the EVI) and a measure of good governance (such as the CPI, CPIA, WGI, etc.)

While the selected indicators and quantitative model can be fairly straightforward and objective, the outcomes need not be. The reasons for this are: (1) the heterogeneity of ACP countries in terms of levels of economic and social development, which can pose difficulties when the same model is applied to all countries; and (2) the fact that the indicators used to meet the various policy guidelines can potentially reward diverging social trends, e.g. countries with low income and human development levels usually also have a poor governance record. The strength and impact of these contending issues depend on the model specifications. Furthermore, the need to resolve contending indicator issues and moderate the variability of ACP country data can create space for external model modifications and adjustments based on the internal judgements of the EC. This suggests that even if an allocation model is based exclusively on 'standard, objective and transparent' criteria, it may still accommodate political interests and subjective judgments regarding the volume and distribution of development aid.

Differentiation, as highlighted by the high share of previous EDF budgets dedicated to LDCs and OLICs, will not be new to the 11th EDF. With up to 80% of the 10th EDF's geographic allocations targeted at the most disadvantaged income groups, it remains to be seen whether the EC can make differentiation even more prominent under the new EDF.

One possible option is for the EC to apply full differentiation of aid levels to HICs and UMICs, either by adopting a very strong poverty focus in the allocation process or by applying external criteria. The alternative is for the EC to apply little or no further differentiation than that already inherent in the 10th EDF. This would imply a stronger focus being placed on performance, good governance and vulnerability.

Irrespective of the option chosen, given the breadth of the EU's development policy and factors informing its differentiation policy, it seems unlikely that the organisation will be able to please all stakeholders. In essence, differentiation implies that there will be winners and losers – the allocations model's first task will hence be to justify these variations.

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