



EUROPEAN COMMISSION
DG DEVELOPMENT

Deputy Director General

Brussels, 13.01.2006
DEV D(06) 250

NOTE TO THE MEMBERS OF THE EDF COMMITTEE

Subject: Cooperation with the ACP countries: 10th EDF aid allocation criteria

Please find enclosed for your information the aid allocation criteria for the national and regional cooperation programmes with the ACP States under the 10th EDF (2008-2013).

The ACP-EU Partnership Agreement (the Cotonou Agreement) foresees that the Community shall give a “clear indication” of the indicative programmable financial allocation at the beginning of the programming process (Annex IV, article 1.b) and that this resource allocation shall be based on needs and performance (Annex IV, article 3.1).

The aid allocation criteria applied for the 9th EDF have been updated in order to respond to the new EU Development Policy Statement (“European consensus”) adopted by the GAERC of 22 November 2005. Three major changes have been introduced compared to the 9th EDF:

- (1) an enhanced focus on social indicators, reflecting the focus on poverty eradication, including the pursuit of the millennium development goals as the primary and overarching objective of the EU development cooperation;
- (2) “the use of standard, objective and transparent resource allocation criteria”;
- (3) a two step approach, whereby an initial indicative amount is communicated to the ACP States and regions at the beginning of the programming process based on quantifiable standard criteria, and a final indicative amount is notified at the end of the programming process which may include an additional “incentive tranche” based on complementary, more qualitative criteria related to governance and the reform agenda of the partner countries and regions.

At the end of the programming process, when the 10th EDF Committee shall be established, we will foresee another discussion on the basis of the final amount which will be proposed for notification and the strategy papers and indicative programmes.

The attached aid allocation criteria concentrate on the first step determining the initial indicative amount on the basis of a quantitative model. The staff working paper is split in two parts. In a first part the approach is further detailed and the aid allocation criteria

shortly presented in non-technical terms. For those interested, a more technical note is annexed to the first part, with a short literature review and a more detailed discussion of the way the criteria have been quantified, standardised and integrated in a multiplicative formula.

(signed)
Athanasios THEODORAKIS

Enclosure.

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EUROPEAN COMMISSION
DG DEVELOPMENT

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DOCUMENT DE TRAVAIL

Critères d'allocation pour l'aide européenne aux pays ACP dans le cadre de la coopération géographique 10e FED couvrant la période 2008-2013

INTRODUCTION

Le 9^e Fonds européen pour le développement (FED) sera entièrement engagé à la fin 2007. L'enveloppe financière pour la coopération géographique avec les pays d'Afrique, des Caraïbes et du Pacifique (ACP) dans le cadre de l'Accord de Partenariat ACP-CE (ci-après nommé Accord de Cotonou)¹ pour la période 2008-2013 (10^e FED) devra être disponible dès début 2008. Pour rendre son utilisation opérationnelle dans les délais, il faut lancer le processus de programmation dès le début de 2006. L'Accord de Cotonou (Annexe IV, article 1.b) prévoit à cet effet qu'au début de la période de programmation la Communauté donne une indication claire de l'enveloppe financière programmable indicative dont les Etats ACP disposeront. A cet effet il faut élaborer un ensemble de critères d'allocation de l'aide.

Dans le cadre de l'Accord de Cotonou, la Commission peut intervenir à trois niveaux : au niveau national, au niveau régional et au niveau intra-ACP. Le protocole financier 9^e FED précisait le montant global réservé au financement des programmes indicatifs nationaux d'une part et le montant global réservé à la coopération régionale et intra-ACP d'autre part.

La coopération intra-ACP vise des actions profitant à de nombreux ou tous les pays ACP (Accord de Cotonou, Annexe IV, article 12). Afin de financer la contribution communautaire à des initiatives globales et afin de pouvoir lancer un certain nombre d'initiatives ACP-UE (initiatives pour l'eau et pour l'énergie), l'enveloppe intra-ACP a connu un développement très important tout au long du 9^e FED. Pour mieux maîtriser l'évolution de cette enveloppe, il sera proposé au groupe ACP de traiter la coopération intra-ACP de manière distincte de la coopération régionale et de prévoir une programmation spécifique basée sur le principe de subsidiarité.

Dans le cadre du 10^e FED, la coopération régionale sera davantage encore que par le passé axée sur l'intégration régionale et notamment sur les accords de partenariats économiques (APE) dont le lancement de la mise en œuvre coïncidera avec le démarrage du prochain FED. La configuration des régions sera par conséquent guidée par la configuration des APE. Le succès de l'intégration régionale repose sur une forte interaction entre les institutions régionales et les gouvernements des Etats constitutifs. Les enveloppes financières allouées à la coopération régionale seront ainsi liées aux allocations nationales sous-jacentes, tout en prenant en compte quelques éléments de différenciation.

Au niveau de la coopération nationale, l'Accord de Cotonou distingue (Annexe IV, article 3.2) une enveloppe pour l'aide programmable (dite « enveloppe A ») et une enveloppe (dite « enveloppe B ») destinée à couvrir des besoins imprévus tels que l'aide d'urgence lorsqu'une telle aide ne peut être financée à partir d'autres sources, budgétaires, des contributions à des initiatives d'allègement de la dette ainsi qu'un soutien destiné à atténuer les effets budgétaires néfastes de l'instabilité des recettes d'exportation à court terme (le mécanisme FLEX).

- La taille nécessaire des enveloppes B pour imprévus est par nature difficile à prévoir et une proposition opérationnelle est faite pour renforcer la solidarité intra-ACP tout en minimisant le risque de geler des fonds dans des enveloppes B qui restent inutilisées.

¹ JO L 317 du 15.12.2000 pour l'accord signé à Cotonou le 23.06.2000, JO L 209 du 11.08.2005 pour la révision de l'accord signée à Luxembourg le 25.06.2005.

- Etant donné le nombre de pays ACP et leur hétérogénéité tant en terme de taille que de niveau de développement, l'exercice le plus complexe consiste à arrêter les critères pour l'allocation des ressources pour les enveloppes A pour aide programmable qui reflètent cette hétérogénéité tout en assurant un équilibre entre besoins et performance afin de maximiser l'efficacité de l'aide en vue de notre objectif primordial de lutte contre la pauvreté.

Ce document de travail de la Commission couvre successivement les critères d'allocation pour les enveloppes A d'aide programmable au niveau des programmes indicatifs nationaux (PIN), les modalités de gestion des enveloppes B et les critères d'allocation pour les programmes indicatifs régionaux (PIR).

1. PROGRAMMES INDICATIFS NATIONAUX, ENVELOPPES PROGRAMMABLES

1.1. Démarche proposée

L'Accord de Cotonou, dans son Annexe IV, article 3(1) donne des indications sur les critères de besoins et de performances à prendre en compte pour l'allocation des ressources entre programmes indicatifs nationaux. Ces critères ont été repris et précisés par la Commission et confirmés dans la déclaration conjointe de la Commission et du Conseil du 22 novembre 2005 sur la politique de développement de l'Union, « le consensus européen »². Il s'agit de critères de besoins mesurant l'étendue et l'intensité de la pauvreté (population, revenu par habitant et besoins sociaux) et de critères de performance (performance financière, économique, politique et sociale, y compris des critères de gouvernance, d'efficacité de l'aide et de mobilisation des ressources internes des pays partenaires) qui favorisent le développement et le progrès vers les objectifs du millénaire pour le développement³.

Reste à rendre opérationnels ces principes généraux. Le consensus européen recommande l'utilisation de **critères « standards, objectifs et transparents »** et de prendre en compte les difficultés particulières auxquelles font face les pays en crise, en conflit ou assujettis à des catastrophes naturelles.

La recherche de critères objectivement mesurables et vérifiables rencontre des limites, en particulier lorsqu'il s'agit de mesurer la performance et plus précisément encore la gouvernance économique et politique. Il va donc de soi que l'approche statistique ne peut se substituer entièrement à l'appréciation politique.

Dans ce cadre, il est proposé une démarche en 2 phases pour déterminer le montant effectif de l'aide programmable (enveloppes A) des programmes indicatifs nationaux :

- Conformément à l'Accord de Cotonou, une indication claire de l'ordre de grandeur potentiel de l'enveloppe A sera communiquée en début du processus de programmation. Cet ordre de grandeur est déterminé sur base d'un modèle quantitatif qui prend comme point de départ l'allocation initiale du 9^e FED, assurant ainsi la continuité, complétée par

² Conseil Affaires Générales et Relations Extérieures, 14820/05 du 22.11.2005, § 62-64.

³ La communication COM (2005)132 du 12.04.2005 sur les objectifs du millénaire pour le développement y ajoute un critère de performance environnemental.

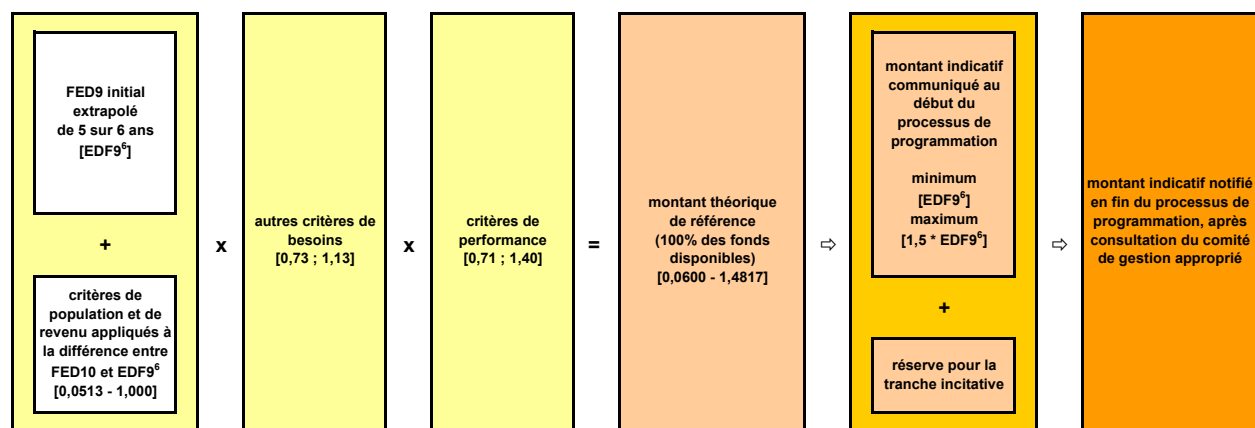
une démarche statistique qui reprend et développe les critères de besoins et de performance à partir de données publiées par des institutions internationales respectées ;

- Au cours de l'exercice de programmation il sera évalué en partenariat avec le pays partenaire si la mobilisation d'une tranche incitative additionnelle peut se justifier. Cette évaluation devra se faire sur base de critères de performance complémentaires et d'engagements de réformes dont la crédibilité devra être appréciée et la mise en œuvre suivie à travers des indicateurs de résultat mesurables. Cette phase de la démarche ne sera pas moins objective et transparente mais portera sur des critères moins quantifiables qui portent notamment sur les éléments essentiels (démocratie, état de droit, droits de l'homme et lutte contre la prolifération des armes de destruction massive) et l'élément fondamental (la bonne gestion des affaires publiques) de l'Accord de Cotonou (articles 9 et 11b de l'Accord révisé).

Cette démarche implique le dialogue et renforce le partenariat. L'aspect contractuel de la programmation renforce l'appropriation de la stratégie de réponse élaborée conjointement. Au bout de la seconde phase, et avant de notifier le montant de l'allocation consolidé résultant de l'exercice de programmation, ce résultat sera présenté au comité de gestion approprié pour avis.

Lors de la revue à mi-parcours, une évaluation de la performance pourra se faire sur base des engagements pris.

La démarche peut être visualisée de la manière suivante :



Sous le 10^e FED, des fonds plus importants seront disponibles par rapport au 9^e FED. Cela permet d'assurer la continuité et la prévisibilité minimale en allouant à chaque pays un montant programmable potentiel qui, sur base annuelle, ne sera pas inférieur à celui sous le 9^e FED extrapolé sur 6 ans (FED9⁶), tout en introduisant une différenciation à la hausse en fonction des besoins et performances⁴. La hausse initiale est plafonnée à 50% d'augmentation par rapport au 9^e FED extrapolé sur 6 ans, mais le processus de programmation permettra de décloisonner cette limitation.

⁴ Les chiffres entre parenthèses carrées représentent la fourchette maximale du poids accordé à chaque groupe d'indicateurs dans le modèle. Ce poids s'exprime comme un coefficient correcteur par rapport au point de départ qui est la population de chaque pays en 2004. Pour plus de détail, voir point 1.4 à la page 11 et l'annexe technique.

Dans des cas bien circonscrits, le Conseil peut s'écarter de cette démarche. Le consensus européen confirme en effet la volonté de maintenir une présence communautaire dans tous les pays ACP. Même dans les Etats fragiles (partenariats difficiles⁵, éventuellement sous article 96, et pays en crise ou sortant de crise, souvent des pays « orphelins » de la communauté des bailleurs), la Commission doit prévoir des moyens suffisants pour y maintenir une aide modulée en fonction de cet environnement difficile afin d'y favoriser la consolidation de l'Etat de droit et la bonne gouvernance. Pour ces Etats fragiles, il ne s'agit pas en premier lieu de déterminer une éventuelle tranche incitative, mais de voir si le montant initial communiqué peut être confirmé dans son ensemble ou partiellement. La mobilisation de fonds pourra être envisagée soit à travers l'enveloppe A de fonds programmables soit, si le contexte d'instabilité ou le contexte de mesures appropriées adoptées par le Conseil dans le cadre du dialogue politique⁶ ne permettent pas une programmation de l'aide, à travers une aide d'urgence et/ou de réhabilitation post-crise à financer à partir de l'enveloppe B destinée à couvrir les besoins imprévus.

1.2. Méthodologie suivie

Par rapport au 9^e FED quelques mises à jour méthodologiques sont proposées :

- Sous le 9^e FED, les grands pays étaient excessivement pénalisés ; il est proposé une légère correction du facteur population, tout en sauvegardant par la prise en compte d'autres facteurs de pauvreté les intérêts des pays les moins avancés de taille moyenne (essentiellement les pays sahéliens) ;
- Sous le 9^e FED, l'impact du revenu par habitant des pays bénéficiaires sur l'aide par habitant était faible ; conformément à la communication sur la politique de développement de l'UE qui demande une attention particulière pour les pays à faible revenu et les pays les moins avancés, il est proposé qu'à partir du seuil des pays à revenu moyen, l'aide par habitant diminue, lentement d'abord, plus rapidement ensuite, toutes choses égales par ailleurs ;
- Sous le 9^e FED, il n'a pas été possible d'anticiper entièrement la dynamique créée par le sommet sur les objectifs du millénaire pour le développement ; il est proposé de renforcer les critères liés aux objectifs du millénaire pour le développement ;
- Pour assurer une approche « standard, objective et transparente », une attention particulière a été donnée à l'identification d'indicateurs accessibles à tous, émanant d'institutions internationales reconnues.

⁵ La COM(2005)311 du 13.07.2005 sur la politique de développement de l'Union définit les partenariats difficiles en fonction de l'un des éléments suivants : absence d'engagements des autorités pour l'objectif de réduction de la pauvreté ; faible gouvernance ; corruption et/ou répression politique ; institutions inaptes à assurer la sécurité des citoyens ou les conditions nécessaires pour vivre en paix et en liberté.

⁶ Dans le cadre de l'article 96 de l'Accord de Cotonou, le Conseil peut dans des cas exceptionnels de violation d'un des éléments essentiels visés à l'article 9, prendre des « mesures appropriées », dont, en dernier recours, une suspension totale ou partielle de l'aide.

- Le modèle quantitatif est construit de manière à pouvoir mesurer le poids et l'impact relatif de chacun des facteurs. Le montant total disponible restant constant, l'introduction de chaque nouveau critère implique une réallocation entre pays ayant des besoins ou des performances au-dessus de la moyenne par rapport aux pays ayant des besoins relatifs moins importants ou une performance moins satisfaisante. Le suivi de l'impact de chaque indicateur se fait par une normalisation de ceux-ci en les transformant en des indices de même unité et par une approche multiplicative⁷.
- Dans ce modèle, le poids cumulatif de la performance peut être significatif. Le tableau à la page 11 indique que l'indice cumulé de performance varie entre 0,71 et 1,40. Cela signifie que si, sur base des critères de besoin uniquement, deux pays ont une allocation initiale de 100, l'un, ayant une excellente performance, peut se voir assigner un montant de 140, tandis que l'autre verra son allocation réduite à 71, créant une disparité de 1 à 2. Pour les pays ayant une performance moins extrême, l'approche multiplicative permet cependant de modérer le poids de celle-ci.

1.3. Critères proposés⁸

1.3.1. Critères de besoins

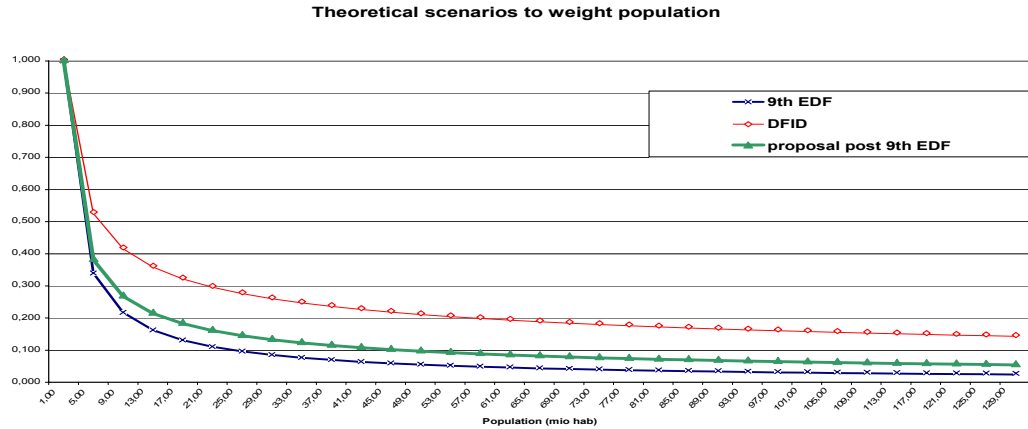
Les besoins sont multidimensionnels et ont tendance à se renforcer mutuellement : une population rurale pauvre et peu scolarisée, frappée par le SIDA, a par exemple une capacité de réaction moindre aux défis de la sécheresse qu'une population plus riche, mieux scolarisée ou en meilleure santé. Il est donc proposé de prendre en compte les critères de besoins de manière multiplicative.

(a) Population

- La population est un indicateur de l'étendue potentielle de la pauvreté. Sur base du principe d'économie d'échelle et de la fragilité et sensibilité des petites économies aux chocs exogènes, il est cependant généralement admis que l'aide par habitant diminue graduellement à partir d'un certain seuil de population. Sous le 9^e FED, cette dégressivité était très forte, le pays le plus peuplé recevant, toutes choses égales par ailleurs, 40 fois moins d'aide par habitant que les pays ayant une population de moins de 1,5 millions d'habitants. Une double correction est proposée, en réduisant le seuil minimum de 1,5 à 1 millions d'habitant et l'écart maximal en aide par habitant à un rapport de 1 à 20, toutes choses égales par ailleurs. Diminuer davantage cet écart se ferait au détriment des pays de taille moyenne qui sont essentiellement des pays pauvres et vulnérables à la sécheresse (pays sahéliens et pays du sud-est de l'Afrique)

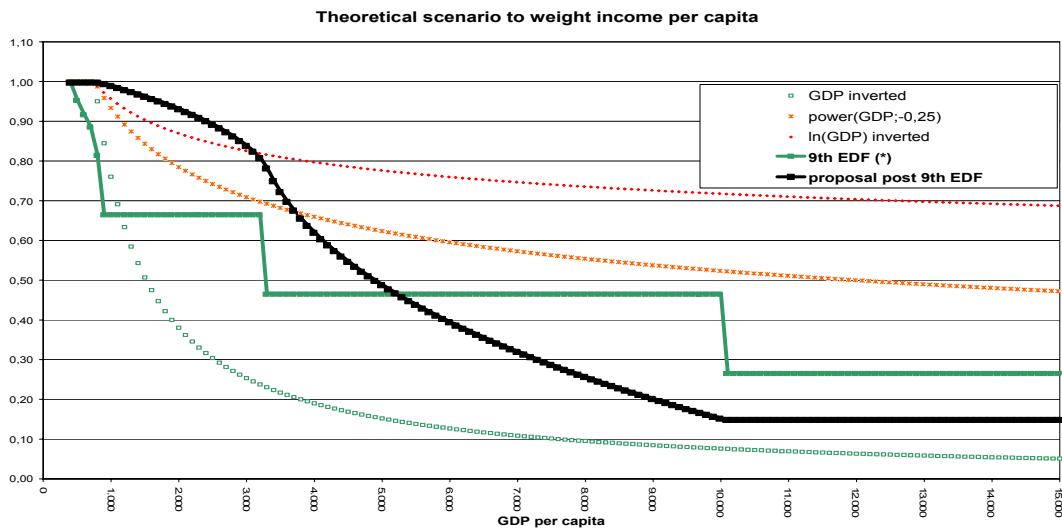
⁷ L'approche multiplicative permet d'explicitier la sensibilité du modèle au poids donné à chaque indicateur et donc les choix politiques exprimés à travers eux. L'approche « additive » alternative consiste à déterminer à l'avance le poids respectif des besoins et de la performance dans l'allocation des ressources, appliquant les coefficients de besoins à x% du montant total disponible et les coefficients de performance à (1-x)% de ce montant, limitant ainsi l'impact de chaque indicateur individuel (voir également note de bas de page 10).

⁸ Pour une présentation technique plus détaillée, voir la note en annexe.



(b) Revenu par habitant

- Le revenu moyen par habitant, exprimé en parité de pouvoir d'achat, indique l'intensité moyenne de la pauvreté mais mesure également les moyens que le gouvernement peut théoriquement mobiliser pour la maîtriser et pour corriger les inégalités et promouvoir la cohésion sociale. L'aide par habitant diminue donc en principe graduellement au fur et à mesure que le revenu par habitant augmente. Cette dégressivité était discontinue sous le 9^e FED, avec un écart maximum de l'ordre de 1 à 4 entre les pays les plus pauvres et les pays les plus riches. Il est proposé une dégressivité plus lisse, lente pour les pays à revenu moyen faible, mais plus forte pour les pays à revenu moyen élevé, de manière à mieux refléter la richesse relative des pays concernés, l'écart maximum passant à un rapport de 1 à 6.



(c) Autres besoins

Les critères de population et de revenu par habitant sont corrigés de la manière suivante :

- L'aide sera accordée sur la période 2008-2013. Il est donc logique d'anticiper le défi démographique future et de prendre en compte la structure démographique des pays bénéficiaires, d'autant plus qu'un pays dont la population est plus jeune, aura des surcoûts de développement importants en terme d'infrastructures sociales d'accueil additionnelles (écoles, centres de santé...). Il est donc proposé de corriger le facteur population pour prendre en compte la dynamique démographique, mesurée par la **part des jeunes de moins de 15 ans dans la population**.
- Certains pays sont particulièrement frappés par la pandémie du SIDA qui hypothèque les perspectives d'avenir et divertit une part importante des revenus des pays concernés pour la lutte contre ce fléau. Il est proposé d'augmenter l'aide par habitant en fonction du **taux de prévalence du SIDA** auprès des adultes de 15 à 45 ans.

S'ajoutent à ces critères de population et de revenu par habitant corrigés des critères reflétant plus directement les **besoins sociaux**. Le potentiel de développement d'un pays peut en effet être hypothéqué par l'état général de misère et la faible qualité de son capital humain qui limitent la capacité des gens à exploiter pleinement leur potentiel de développement. Pour les sortir du « piège de la pauvreté », une aide par habitant plus importante est justifiée, non seulement sur la base de critères d'éthique sociale mais également d'efficacité économique.

- Pour mesurer l'intensité des besoins sociaux, il est proposé d'utiliser l'**indice de pauvreté humaine**, développé par le PNUD. Il prend en compte la probabilité à la naissance de ne pas survivre au-delà de 40 ans, l'analphabétisme adulte, le nombre de personnes qui n'ont pas accès à une source d'eau améliorée et le nombre d'enfants de moins de 5 ans modérément ou sévèrement mal nourris. Puisque dans le cadre des perspectives financières la ligne budgétaire d'appui à la **sécurité alimentaire** ne prévoit plus une approche géographique programmée⁹, un léger rééquilibrage en faveur des pays bénéficiaires de cette aide est proposé en renforçant le poids de la prévalence de la sous-alimentation sévère auprès des enfants de moins de 5 ans dans l'indice correcteur de pauvreté humaine.
- L'Accord de Cotonou demande une attention particulière pour les **pays vulnérables**. Certaines causes de vulnérabilité clairement identifiées (instabilité des recettes d'exportation, catastrophes naturelles et autres imprévus déclenchant un besoin d'aide humanitaire ou d'urgence) sont cependant déjà prises en compte à travers les interventions sur l'enveloppe B des allocations nationales (voir également point 2 plus bas). La vulnérabilité structurelle liée à la dépendance économique est quant à elle très fortement liée à la taille de l'économie, les petits Etats ayant en moyenne une économie nettement moins diversifiée et donc plus sensible aux chocs extérieurs ; ce facteur est également déjà pris en compte à travers l'indicateur de population qui privilégie très fortement les petits Etats.
 - Il est par contre proposé de prendre en compte une situation plus générale d'incertitude et d'insécurité qui freine l'investissement et hypothèque l'avenir. Cette instabilité générale (qui peut être d'origine tant économique que politique, y compris des situations de crise et de guerre) se reflète dans la **variation du taux**

⁹ Suite à la COM(2005)324 du 03.08.2005 sur les lignes thématiques, une communication complémentaire de la Commission sur la stratégie de promotion de la sécurité alimentaire est attendue pour début 2006.

de croissance du produit national brut autour de sa moyenne au cours des 25 dernières années.

- A cette mesure d'instabilité s'ajoute conformément à l'Accord de Cotonou des mesures plus spécifiques qui prennent en compte
 - Les handicaps structurels des **pays les moins avancés** (+5%),
 - Les handicaps liés à la situation géographique de **pays enclavés** (+5%) **ou insulaires** (+10%). Ce facteur géographique est complété par d'autres critères d'isolement : l'éloignement des principaux marchés extérieurs (mesuré par la part relative des coûts de transport dans la valeur des importations) et la faible urbanisation et densité de population qui contribuent à augmenter les frais de transport et les frais d'infrastructure, et ralentissent la circulation des idées et des biens et services pour le développement.

1.3.2. Critères de performance

Il est difficile de traduire une réalité complexe et multiforme sur le terrain par des indicateurs quantitatifs de performance. Pour certaines dimensions de performance, des critères mesurables sont proposés, pour d'autres, une appréciation complémentaire sera nécessaire dans le cadre du dialogue au cours de la période de programmation. L'approche multiplicative renforce déjà l'impact des critères de performance retenus à ce stade, ceci afin de s'assurer que l'aide soit perçue comme une incitation à la bonne gouvernance¹⁰.

(a) Performance de l'aide octroyée

- Indépendamment des besoins, l'augmentation des allocations doit prendre en compte la capacité d'absorption des pays bénéficiaires. Il est proposé de mesurer la **capacité d'absorption** par un facteur combiné du taux actuel d'engagement du 9^{ème} FED initial et le rapport entre ce qui « reste à liquider » (le montant des paiements restant à faire sur le portefeuille de projets en cours) et les décaissements annuels moyens¹¹. L'impact correcteur à la baisse de ce critère est limité à maximum -20% afin de ne pas indûment pénaliser des pays dont la capacité d'absorption s'est améliorée récemment.
- Indépendamment de la capacité financière à absorber les fonds, reste à savoir avec quelle efficacité l'aide est absorbée. Le risque d'une utilité marginale décroissante de l'aide à partir d'un certain seuil de dépendance est réel, l'aide extérieure finissant par se substituer aux efforts internes d'épargne et d'investissement. Si une certaine sélectivité dans l'allocation de l'aide est nécessaire, une concentration excessive nuit à son efficacité. C'est pour cela qu'il est proposé de légèrement corriger le facteur de performance par un facteur de **dépendance d'aide extérieure**.

¹⁰ Dans le modèle proposé, le coefficient d'impact consolidé de la performance fluctue entre -29 et +40%. Cela signifie, pour prendre l'exemple le plus extrême, que pour deux pays qui sur base de leurs besoins auraient eu une même allocation de 100, l'un pourrait voir son allocation retomber à 71 et l'autre voir son allocation augmenter jusqu'à 140, soit un écart de 1/2. Pour obtenir une même différenciation à travers une démarche additive, il faudrait donner à la performance un poids minimum de 50%.

¹¹ Ce ratio devrait tendre vers 3, signifiant que sans nouveaux engagements, il faudrait théoriquement 3 ans pour liquider tous les projets en cours.

(b) Performance économique

Plusieurs dimensions de la gouvernance économique, telles que la corruption, la qualité de la gestion des finances publiques, l'insécurité juridique etc. sont difficilement saisissables par des indicateurs quantifiés. Ces dimensions sont mieux appréhendées dans le cadre du dialogue avec le pays partenaire sur la programmation lors de la seconde phase de détermination du montant effectif de l'aide programmable. Pour la détermination générale de l'allocation initiale de l'enveloppe A, une distinction est faite entre **performance macro-économique** et facteurs influençant le **climat d'investissement**. Nous proposons de prendre en compte les variables suivantes :

- Au niveau macro-économique : le taux de **croissance récent de l'économie**. Cette variable est cependant corrigée par des indicateurs de viabilité à moyen terme :
 - un facteur combiné de **viabilité écologique** : exploitation non renouvelable de ressources naturelles (permettant notamment de relativiser la performance des pays exportateurs de pétrole) et pression sur les terres arables qui peuvent hypothéquer la croissance à long terme dans les pays fortement dépendant de l'agriculture) ;
 - **l'évolution relative de la dette extérieure** qui donne une indication de la viabilité à moyen terme de cette croissance ; cette variable rend également compte de la qualité des relations que le pays entretient avec ses créiteurs extérieurs, notamment dans le cadre de l'initiative en faveur des pays pauvres très endettés ;
 - l'importance relative de **la réallocation des ressources sur enveloppe A lors de la revue à mi-parcours** dans le cadre du 9^e FED reflète notre évaluation de la performance récente du pays partenaire et notamment le respect des réformes et mesures annoncées dans le document de stratégie initial. Cet indicateur exprime la confiance que nous avons dans la capacité du gouvernement à poursuivre son effort, d'absorber l'aide supplémentaire éventuellement accordée, de gérer ses finances publiques selon des standards acceptables et à stabiliser sa situation macro-économique à moyen terme.
- Au niveau du climat d'investissement : **climat des affaires** (mesuré par un indice composé à partir des données rassemblées par la Banque Mondiale sur la durée nécessaire pour la création d'une entreprise, l'enregistrement d'un bien immobilier et le règlement d'un litige commercial), **niveau de protection tarifaire extérieure**, part des **investissements directs extérieurs** dans la formation brute de capital fixe et part de la **formation brute domestique de capital fixe** dans le produit intérieur brut du pays

(c) Performance politique

Plus encore que pour l'économie, la gouvernance politique est difficilement mesurable par des données statistiques. Il existe des indices combinés établis par des centres de recherche internationaux, surtout américains, mais ces indices ont souvent une couverture géographique insuffisante, posent des problèmes de lisibilité (additionnant des facteurs qualitatifs de nature très différente, rendant leur interprétation peu transparente), sont parfois idéologiquement biaisés ou mesurent le formalisme procédurier du processus politique. Il est par conséquent proposé

d'aborder la dimension politique de préférence dans le cadre du dialogue avec les parties prenantes au cours du processus de programmation.

(d) Performance sociale

Les mesures d'inégalité des revenus et/ou de la pauvreté ne sont malheureusement pas disponibles dans de nombreux pays et/ou ne sont pas toujours comparables, ni dans le temps ni entre pays. De toute manière les critères monétaires restent des indicateurs très partiels de la cohésion sociale. D'autres indicateurs plus qualitatifs permettent de mesurer la performance et la cohésion sociale, tant au niveau des politiques qu'au niveau de l'impact de ces politiques :

- Au niveau politique, on compare la part relative des dépenses publiques consacrées aux **secteurs sociaux** de l'éducation (affinée par la part des dépenses allant au secteur de l'éducation primaire et l'aspect genre) et de la santé par rapport aux dépenses militaires ;
- Au niveau sectoriel, on prend en compte le chemin déjà parcouru dans l'atteinte des **objectifs du millénaire pour le développement** dans le secteur de l'éducation (**éducation primaire pour tous** en 2015) et de la santé (réduction de 2/3 de **la mortalité des enfants de moins de 5 ans** pour 2015).

1.4. Résultats

Le modèle présenté de manière plus détaillé en annexe permet de désagréger la pondération et l'impact de chacun des indicateurs proposés¹².

Indicateur	pondération	impact sur l'allocation
Critères de besoin de base		[-95% ; 0%]
- population		[-95% ; 0%]
- revenu par habitant (en parité de pouvoir d'achat)		[-85% ; 0%]
Autres critères de besoin		[-27% ; +13%]
- part des jeunes (<15 ans) dans la population	[0% ; 13%]	
- prévalence du SIDA dans la population active (15-49 ans)	[0% ; 18%]	
- privation sociale (indice de pauvreté PNUD)	[0% ; 27%]	
- malnutrition auprès des enfants (< 5 ans)	[0% ; 08%]	
- vulnérabilité	[1% ; 14%]	
- volatilité de la croissance économique	[1% ; 15%]	
- pays les moins avancés	+ 5%	
- isolement géographique	[0% ; 13%]	
- pays enclavés ou insulaires	+ 5% ou 10%	
Critères de performance		[-29% ; +40%]
- performance financière	[-20% ; +17%]	
- performance de l'aide communautaire	[-19% ; +19%]	
- dépendance de l'aide extérieure	[-11% ; 0%]	
- performance économique	[-14% ; +16%]	
- croissance économique soutenable	[-19% ; +32%]	
- climat d'investissement	[-9% ; +7%]	
- performance sociale	[-20% ; +20%]	
- dépenses (santé+éducation / militaires)	[-23% ; +24%]	
- progrès vers éducation primaire pour tous (+ genre)	[-28% ; +12%]	
- progrès vers réduction de la mortalité infantile (<5 ans)	[-10% ; +29%]	
Effet combiné des autres critères de besoin et de performance		[-30% ; +44%]

¹² La complexité apparente de certaines formules utilisées découle essentiellement de la nécessité de transformer les indicateurs en indices comparables et de les calibrer afin d'en délimiter le poids et l'impact (voir discussion technique plus détaillée en annexe). Le poids respectif des différentes variables résulte d'un arbitrage politique et non technique.

L'introduction d'un seuil minimum égal au 9^e FED extrapolé à six ans et le plafonnement de la croissance du montant initial à 50% du 9^e FED extrapolé, a un effet sur les coefficients d'impact. Cet impact reste cependant modeste¹³.

Il reste à préciser que le modèle résulte dans une allocation des ressources telle qu'au moins 90% de l'aide programmable soit allouée aux pays les moins avancés et les pays à revenu faible et qu'au moins 90% de l'aide programmable soit allouée à l'Afrique sub-Saharienne.

2. PROGRAMMES INDICATIFS NATIONAUX, ENVELOPPES POUR IMPREVUS

Sur base de l'historique actuel d'utilisation des enveloppes B et en prenant en compte les besoins non satisfaits, en particulier au titre du FLEX pour la couverture des pertes d'exportations dans les pays pour lesquels l'enveloppe B est déjà épuisée, on peut estimer le niveau annuel moyen d'utilisation de l'enveloppe B à environs €300 million¹⁴. La réserve prudentielle cumulée sur les 6 ans du post 9^{ème} FED devrait ainsi être de l'ordre de €1,8 milliards.

Le taux annuel moyen d'utilisation de l'enveloppe B représente moins de 3% des enveloppes A sous le 9^{ème} FED. La dispersion autour de cette moyenne est cependant importante. Dans 30% des pays ACP, l'enveloppe B n'a jamais été utilisée, mais dans les Caraïbes et le Pacifique le taux annuel moyen d'utilisation est de 5 à 10%, voir plus, de l'enveloppe A.

Dans ce contexte, il est proposé d'attribuer comme point de départ environ €600 million aux enveloppes B, couvrant les besoins théoriques pour les 2 premières années du post 9^{ème} FED et permettant ainsi dès la première revue annuelle d'ajuster les enveloppes B en fonction des utilisations déjà faites.

La répartition par pays du montant initial de €600 million sera faite comme suit :

- étant donné le faible taux d'utilisation de l'aide humanitaire initiée par ECHO et le nombre significatif de pays n'ayant jamais fait appel à l'enveloppe B, une allocation de base minimale de l'ordre de 1,5% de l'enveloppe A pour tous les pays, avec un minimum de €0,2 million ;
- complété jusqu'à concurrence de €600 million au pro rata de l'utilisation relative faite par les différents pays de l'enveloppe B au cours du 9^{ème} FED.

3. PROGRAMMES INDICATIFS REGIONAUX

L'intégration régionale et les APE seront au cœur de la programmation régionale. Dans ce contexte il est important d'assurer une interaction importante entre la programmation nationale et

¹³ Seulement un nombre limité de pays sont concernés et ceci pour un montant consolidé inférieur à 1% de l'enveloppe d'aide programmable.

¹⁴ Abstraction est faite dans ce calcul de la contribution non renouvelable à la Facilité pour la Paix et des cas d'augmentation des enveloppes B à partir des enveloppes A dans des pays en crise ou post-crise pour lesquels l'enveloppe A n'est pas accessible.

régionale et de renforcer le poids de la coopération régionale, tout en s'assurant de la capacité des structures régionales à absorber l'augmentation considérable de l'aide. Etant donné le lien entre les besoins de programmation régionaux et la taille et la structure des économies sous-jacentes, il est proposé de prendre comme point de départ pour les allocations régionales **13% des allocations nationales (enveloppes A)** des Etats membres constituant la région¹⁵.

Les objectifs de l'intégration régionale, les contraintes et défis posés sont très différents d'une région à une autre et il est par conséquent difficile de quantifier des critères d'allocation spécifiques liés à ce processus d'intégration régionale. Certains critères assimilables à des critères de besoins peuvent cependant être identifiés pour corriger ce montant initial:

Ce montant initial est ensuite corrigé de la manière suivante :

- une correction basée sur une prise en compte de la part de chaque région dans l'utilisation théorique¹⁶ des enveloppes B sous le 9^e FED pour couvrir les imprévus. Cette correction cherche à rendre compte de **la vulnérabilité** des régions aux chocs extérieurs et aux catastrophes naturelles. Cette vulnérabilité engendre en effet des coûts supplémentaires résultant de la nécessité de renforcer les mesures de prévention et de maîtrise des effets de ces chocs exogènes.
- Une correction forfaitaire, fixée à 10% pour refléter **le caractère insulaire** de certaines régions. Les Caraïbes et le Pacifique ont en effet des problèmes de communication et doivent faire face à des défis environnementaux spécifiques qui justifient un traitement privilégié.
- Une correction reflétant l'importance relative du **commerce intra-régional** dans le commerce total de la région.
- Une correction reflétant **la performance dans la mise en œuvre du programme indicatif régional 9^e FED** basée sur la part relative des réallocations prévues dans le cadre de la revue à mi-parcours et dont les résultats seront soumis au comité du FED en début 2006.

Ces correctifs permettent de moduler l'allocation PIR dans une fourchette corrective de [-23% à +73%].

La programmation régionale se déroulera de la même manière que la programmation nationale, en deux étapes, avec dans un premier temps un montant indicatif provisoire communiqué en début du processus de programmation, susceptible par la suite être complété par une tranche incitative. Il sera tenu compte de l'agenda d'intégration régionale et de la crédibilité des engagements pris pour sa mise en œuvre pour déterminer le montant de la tranche incitative.

¹⁵ La configuration des APE et par conséquent des régions pour le 10^e FED n'est pas encore définitivement arrêtée.

¹⁶ Le montant théorique d'utilisation des enveloppes B est égal au montant d'utilisation effectif des enveloppes B auquel s'ajoute les besoins chiffrés dans le cadre du FLEX auxquels on n'a pas pu répondre dans certains pays à cause de l'épuisement de l'enveloppe B nationale.

TECHNICAL ANNEX

Post 9th EDF aid allocation criteria for programmable funds under the National Indicative Programmes for ACP countries

Executive summary

The ACP-EC Partnership Agreement (hereafter referred to as the ‘Cotonou Agreement’)¹⁷ and the “european consensus” on the European Union Development Policy (EU, 2005b) specify that initial resource allocation shall be based on needs and performance. Both documents give further indications on the needs and performance indicators to be included in the exercise and on the methodology used, stressing the importance of an objective and transparent approach.

These general principles have to be operationalised at three levels:

- Allocation criteria for the funds earmarked for the programmable part of the national indicative programmes (“A envelopes”);
- Allocation criteria for the funds destined for unforeseen needs under the national indicative programmes (“B envelopes”)
- Allocation criteria for the regional indicative programmes.

The allocation criteria for the “A envelopes” require a more detailed technical explanation.

The staff working document is structured as follows:

1. A conceptual background which outlines the major recent theoretical debates with regard to the appropriate weighting for to needs and performance in the aid allocation criteria. This introductory part also assesses the strengths and weaknesses of various statistical approaches to quantify needs and performance, concluding with the options chosen for the post 9th EDF.
2. An overview of the various needs indicators considered for the quantitative aid allocation model and the way they have been quantified.
3. An overview of the performance indicators retained for the quantitative aid allocation model and the way they have been quantified.
4. A concluding chapter presenting the consolidated aid allocation model. This includes a global assessment of the limitations of the model, a summary of the relative impact of the various needs and performance indicators on the end result and the extent to which the model integrates the millennium development goals (MDGs).

1. Background

The Cotonou Agreement states (Annex IV, article 3) that resource allocation shall be based on needs and performance. The (EU, 2005b) specifies (§ 64-66) that:

1. the criteria used shall be standard, objective and transparent;

¹⁷ ACP-EC Partnership Agreement signed in Cotonou on 23.06.2000 [OJ L 317, 15.12.2000], revised in Luxemburg on 24.06.2005 [OJ L 209, 11.08.2005].

2. the particular difficulties faced by countries in crisis, in conflict or disaster-prone shall be borne in mind;
3. the distribution of resources shall take into account the effect of such resources on poverty reduction.

The table below summarises the criteria suggested in the Cotonou Agreement, the criteria used for the 9th EDF and the European consensus.

Cotonou Agreement	9th EDF	European consensus
Needs: <ul style="list-style-type: none"> - population size - income per capita - social indicators - economic indicators (level of indebtedness, export earning losses and dependence on export earnings) 	Needs: <ul style="list-style-type: none"> - population size - GNP per capita (level of poverty) - social development (life expectancy and education components of HDI) 	Needs: <ul style="list-style-type: none"> - population - income per capita - extent of poverty - income distribution - level of social development
<ul style="list-style-type: none"> - LDCs, vulnerable island and landlocked states - special attention for countries dealing with the aftermath of conflict or natural disaster 	<ul style="list-style-type: none"> - vulnerability (LDCs, island, landlocked and post conflict countries) 	<ul style="list-style-type: none"> - countries in crisis, in conflict, disaster-prone - priority to LDCs and other LICs, appropriate attention to LMICs - specific focus on Africa
Performance: <ul style="list-style-type: none"> - aid performance (use of resources and effective implementation of current operations) - macroeconomic and sectoral policy performance - progress in implementing institutional reform - poverty alleviation, sustainable development 	Performance: <ul style="list-style-type: none"> - aid performance (absorption capacity, based on commitments) - macroeconomic performance and structural adjustment - political performance (based on armed conflict, human rights and institutional accountability) - social development (notably life expectancy and education) 	Performance¹⁸: <ul style="list-style-type: none"> - effective use of aid (aid absorption capacity) - use of scarce resources - political, economic and social progress - good governance
	Envelop for non-programmable resources based on <ul style="list-style-type: none"> - economic vulnerability index - share of Stabex/Sysmin in aid - HIPC countries - natural disasters and conflicts 	

While there is consistency over time and over regions about the broad nature of the criteria to be used in the aid allocation exercise, increasing attention has been paid to the integration of key, results-oriented indicators in the context of the millennium development goals (MDGs). The way the criteria are measured and their respective weighting has been the object of an international debate in recent years. This debate and the emphasis on MDGs should be reflected in the updated aid allocation criteria.

Four main issues are raised in this context:

- The relative importance of needs versus performance indicators
- Derived thereof, the degree of selectivity applied
- The importance of exogenous shocks and the way resources are allocated to fragile states

¹⁸ The COM(2005)132 of 12.04.2005 on the MDGs introduces an additional environmental performance criterion.

- Methodological issues related to the collection, quality and compilation of data

1.1. Needs versus performance

Starting from the premise that “*the primary and overarching objective of EU development cooperation is the eradication of poverty in the context of sustainable development, including pursuit of the Millennium Development Goals*” (EU, 2005b, § 5), aid should be primarily directed towards those countries where absolute poverty and the prevalence of poverty are the highest.

Absolute poverty is often defined in monetary terms, but poverty is a much broader concept, which could be defined as a lack of “capability”: poor are less healthy, are less literate, are more dependent and therefore have less voice and have less access to social services, reinforcing the poverty trap (SEN, 1999; UNDP, 2004).

- A measurement of needs therefore has to go beyond an income per capita approach but should include social indicators of deprivation.
- While income is too narrow a concept to measure poverty at micro-level, at macro-level it remains a strong indicator of the means available within the society at large to reduce poverty. Everything else remaining equal, the higher average income per capita, at purchasing power parity, the lesser the need for additional external concessional resources to fight poverty.
- However, everything is not equal. Various contextual factors which in the short and medium term can be treated as exogenous may significantly increase the costs of fighting poverty: geographic isolation, climatic conditions and vulnerability to economic shocks and pandemics reorient a disproportionate share of revenue towards overcoming these constraints.

When comparing two countries with a similar average per capita income, the **prevalence of poverty** may be very different. Prevalence of poverty refers to the distribution of wealth and income and introduces the concept of inequality. Even in wealthier countries, pockets of absolute poverty may subsist. The problem is then no longer one of unmet needs but of unevenly distributed means to fight poverty and/or of differential effectiveness of mobilising these means. In other words, the willingness to conduct poverty reduction policies and their effectiveness may vary.

Where policies differ, problems of **moral hazard** arise (COLLIER & DOLLAR, 2004), especially in a world where aid allocation is perceived as a zero sum game with countries competing for a fixed amount of aid. In a purely needs-driven approach, proportionally more aid should go to countries with a similar real income level but higher prevalence of poverty. Such approach runs the risk of rewarding countries that are less sensitive to social justice and sustainable development to the detriment of countries which perform better in reducing poverty. In some circumstances, aid may even result in slowing down reform and feed a corrupt government system.

In economic efficiency terms, the additional funding given to a poorly performing country may be less effectively used than additional aid oriented towards well performing countries. The study by (BURNSIDE & COLLIER, 1997), popularised through (WB, 1998), has generated a whole debate on the **effectiveness of aid**¹⁹. Case studies as well as cross-country econometric models seem to indicate that, everything else remaining equal, there is a positive correlation between macro-economic and political performance and the effectiveness of aid. This could lead to the conclusion that aid allocation should be redirected exclusively towards developing countries implementing effective economic and political reforms and guaranteeing an optimal use of the external aid made available.

However, causality between growth and good governance and between good governance and aid runs both ways. Good governance cannot therefore be taken as an exclusive condition for aid allocation (JACQUET 2003). In addition, when other explanatory variables are introduced in the equation, the correlation between aid effectiveness and economic governance becomes statistically less significant, implying that the “performance” variable may hide more relevant factors impacting the effectiveness of aid²⁰. (AMPROU & CHAUVET, 2004) identifies four categories of additional explanatory variables of aid effectiveness:

- The decreasing marginal utility of aid, due to a “dutch disease” effect of the influx of foreign exchange leading to a revaluation of the national currency or simply to diminishing return on investment²¹;
- Vulnerability to external shocks may hamper growth, while aid may help overcome resulting bottlenecks or cushion the impact of the shocks;
- Volatility and unpredictability of aid which, when allocated pro-cyclically, may reinforce macroeconomic volatility and undermine aid effectiveness;
- Other forms of instability which may not be linked to domestic performance, such as regional instability which results in a decrease in regional trade and may have spill over effects on military expenditures and loss of investors confidence due to contagion fear²².

¹⁹ Useful overviews in (McGILLIVRAY, 2003; AMPROU & CHAUVET, 2004; COGNEAU & NAUDET, 2004).

²⁰ (COLLIER & DOLLAR, 2004) and (EASTERLY e.a., 2004) cite various studies, some demonstrating that aid can be effective, regardless of the policy environment, others showing that aid is ineffective, regardless the quality of the poverty reduction strategies. According to (FENG, 2003), these apparent contradictions are the result of an excessive aggregation of the explanatory variables, hiding the reverse causality issues: aid can have a direct (e.g. through conditionalities) or indirect (e.g. through investment in human capital) impact on the quality of governance, with different time gaps, while governance can also have a differential impact on aid effectiveness over time.

²¹ Time series analysis confirms that increased aid dependency may lead to a situation whereby the substitution effect of structural reforms which attract more aid become increasingly overwhelmed by the income effect whereby more aid makes it less necessary to implement reforms (aid linked to governance increases pressure to reduce corruption but aid diminishes the requirement for internal taxation and ultimately for domestic accountability). Cross country economic models are more ambiguous (BURNSIDE & DOLLAR, 2004). In highly aid dependent LICs, aid is much less fungible than in MICs so that donor leverage (and aid effectiveness) may increase (MOSLEY e.a., 2004). However, in studies explaining economic performance, the introduction not only of the volume of aid but also the squared volume of aid as explanatory variable, leads to statistically significant results, confirming the non-linearity hypothesis and the thesis of diminishing returns on aid.

²² While domestic political instability will negatively affect aid effectiveness, regional instability may enhance aid effectiveness in a similar way as aid may help absorb the impact of external shocks.

In more general terms, there appears to be confusion between reform efforts and performance, whereby the impact and time lag of good governance efforts may differ widely depending on the structural constraints in which a country operates²³.

The results of this debate are not clear-cut but it appears that aid effectiveness depends not so much on past performance than on the ongoing development focus of policy-makers and their willingness to reform²⁴, taking into account structural circumstances, and that there is a two-way interaction between aid effectiveness and performance. This has an important impact on the degree of selectivity donors should adopt in their aid allocation decisions.

1.2. Selectivity and incentives

The trade-off between a needs-driven and a performance driven approach can theoretically be formalised by the “poverty elasticity of aid”, whereby, taking into account past performance in transforming means in poverty combating measures, the impact of a unit of aid on reducing poverty can be estimated²⁵.

The two main avenues to influence the poverty elasticity of aid at the policy level, regardless of the implementation modalities are:

- either the introduction of a series of “conditions” to the disbursement of aid, in order to ensure its optimal use. However, conditionality has proven disappointing²⁶:
 - The lack of ownership of the adjustment measures do not lead to sustained reforms,
 - The inconsistent and asymmetric donor behaviour, quick in increasing aid when pro-poor policies are implemented but reluctant to review aid downwards when these policies are retracted or neutralised by negative policies, have undermined the credibility of donor imposed conditionalities,
 - The tendency to multiply conditionalities and to underestimate the transaction costs and institutional constraints to tackle all conditionalities of all donors up

²³ (COGNEAU & NAUDET, 2004) for an extensive discussion of this issue. They point out that the World Bank’s “Country Policy and Institutional Assessment” (CPIA) index used as a proxy for economic governance in (COLLIER & DOLLAR, 2002) only explains 10% of the growth difference between Sub-Saharan Africa and South-East Asia. (MILANOVIC, 2005) point to the reverse causality, high present growth rates and the LDC status highly influencing the CPIA score. (KAUFMAN & KRAAY, 2002) highlight the difference between a static measure of governance and a dynamic measure of adjustment efforts.

²⁴ As pointed out in (MOSLEY e.a., 2004), exogenous factors may impact effectiveness, but cannot undermine completely the freedom of governments to pursue good/bad policies and the ability of aid to impact upon such policies.

²⁵ See (COLLIER & DOLLAR, 2002) and for a critical assessment of this approach (COGNEAU & NAUDET, 2004). The main methodological problems with this approach are the hypothesis of constant poverty elasticity of growth and aid regardless of initial income level and income distribution and the fact that the theoretical aid optimisation exercise is based on a measure of past performance (the World Bank’s CPIA index). The assumption that past (CPIA) performance is a good indicator of present and future performance implies that the performance indicator captures structural factors or governance factors with an important time lag; this approach penalises countries which have initiated pro-poor development policies in recent years and where aid effectiveness could be maximised despite lack of immediately observable performance improvements.

²⁶ (EASTERLY, 2005) concludes that, as for aid overall, conditionality dependent structural adjustment has not been very good in promoting good policy (and that the period a country has been under structural adjustment is a poor indicator of performance), thereby calling for a more cautious approach to selectivity.

front has overburdened the limited institutional capacity of the recipient countries and the monitoring capacity of the donor community.

- or more selectivity in the initial aid allocation. Taken to the extreme, increased selectivity should lead to cutting off entirely aid to poor performers and to concentrate solely on good performing countries.
 - This approach is ethically difficult to defend in its extreme form whereby the poor are abandoned twice, once by their leaders and another time by the international donor community.
 - Even in efficiency terms, this approach may be criticised:
 - it neglects the longer term dynamics of the development process, whereby investing in human capital (health and education) has proven a powerful instrument to initiate a democratisation process (FENG, 2003) and to escape from the poverty trap (SACHS, 2005)
 - in its extreme forms it leads to exclusive concentration of aid in a limited number of countries (RADELET, 2004; COLLIER & DOLLAR, 2004), with increased transaction costs, decreasing marginal utility of aid and increased volatility of aid which goes against aid predictability (OECD, 2005; OECD, 2005a)²⁷
 - Furthermore, this approach does not discriminate between countries with weak performance as a result of structural handicaps and lack of institutional capabilities and countries with predatory governments nor does it take into account rapidly changing political circumstances, penalising countries for their past performance rather than for their present behaviour (COGNEAU & NAUDET, 2004).

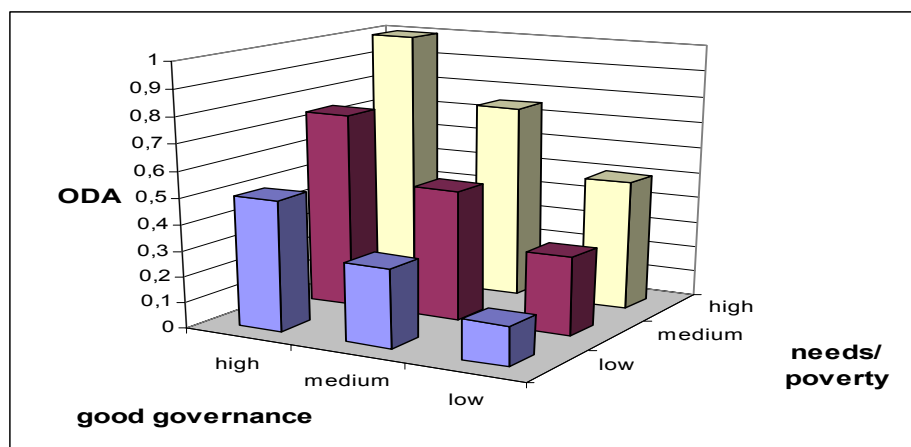
Both approaches result in an **exclusion logic**, the one ex post, the other ex ante²⁸.

A more constructive and pragmatic approach, based on “pull factors” (RADELET, 2005) consists in allocating a more moderate initial envelop to all targeted developing countries, based mainly on needs and absorption capacity and to build in a rolling programming process whereby throughout the programming cycle regular upward adjustments can be made in function of commitments to reform, performance and special circumstances. In this scenario, performance is no longer defined in a static way based on past experience, but in terms of financial, economic, political and social capacity of the country to absorb the earmarked funding in an effective, pro-poor way. Such an approach enhances policy dialogue and ownership and leads to what (EC, 2005a) describes as the **contract approach** compared to the traditional conditionality approach.

²⁷The USAid Millennium Challenge Account is probably the most extreme performance-drive approach so far, leading to the selection of a very restricted number of “donor darlings” and increased political dependency. As pointed out by (OECD, 2005a), marginalisation may be the unintentional collective outcome of uncoordinated decisions by individual donors, leading to “donor orphans”, i.e. countries that receive even less than their poor governance indicators would warrant if aid was allocated more consistently according to governance scores across all countries. In pure complementarity logic, a donor could opt for a strategy of filling in the gap in under-aided countries, but again, this could lead to highly distorted and volatile aid allocations if other donors would follow the same strategy (see DFID, 2003).

²⁸ Although, as pointed out by (HUDSON, 2004), the ex post approach with conditionalities at least has the advantage that it is more conducive to a dialogue.

It also allows a more systematic development of a typology of aid delivery mechanisms and aid volume adapted to the absorption capacity and performance of the recipient country.



Where poverty is not too widespread and means to fight poverty controlled by predatory leaders, no support should be given, except for targeted grass-root actions through the non-state actors, focusing on the essential and fundamental elements of Cotonou²⁹. Where needs are high and means to fight poverty limited but there is a strong will to implement a coherent poverty reduction strategy, pro-poor programmes can be conceived in partnership with the Government, and aid can be stepped up to enhance institutional capacity building, possibly complemented by sector-wide programmes. Where capacity is increasing, budget support type approaches can increasingly be tried, further enhancing the absorption capacity³⁰.

This needs based contractual approach also helps to face the aid paradox in a purely performance driven scenario. Indeed, the better is economic governance and performance, the easier recipient countries may access international capital markets and the less concessional aid they need. Grant based aid should therefore be phased out, but gradually in order to avoid creating a disincentive to good behaviour.

1.3 Exogenous shocks, conflict and post-conflict countries

Needs may be durably influenced by structural constraints and exogenous factors. Some structural constraints lead to a poverty trap and are reflected in the development level used as criterion in a needs-driven aid allocation model (SACHS e.a., 2005). Other exogenous factors such as natural resource abundance are more difficult to capture because their net impact on

²⁹ In extreme cases of bad performance or when the partner country is not cooperating in countering the proliferation of weapons of mass destruction (Cotonou Agreement, article 11b), aid could be limited to 15% of the theoretical, needs based NIP, corresponding to the share of NIPs which under the 9th EDF could be channelled through the non-state actors, and mirroring the (OECD, 2005) target that 85% of aid is integrated in government budget.

³⁰ (COLLIER & DOLLAR, 2004) distinguish between “working around” governments on the one side and “working through” governments on the other side (thereby defining jointly with the recipient country outcome indicators and leaving the freedom to the Government to define its policies to get there), with in between the option of “working with” the government, covering traditional programme aid whereby policies and interventions are all fixed in advance.

economic growth and poverty reduction will be strongly influenced by the quality of political and economic governance and there is no robust correlation between natural resource endowment and economic growth.

By contrast, exogenous shocks which lead to short term macroeconomic volatility may significantly slow down long term growth prospects³¹. As shown by (DERCON, 2005), the development potentials of an individual are not only determined by the level of poverty and deprivation, but also by risk. Resilience to external shocks is positively correlated to wealth. In addition the impact of external shocks on poor is asymmetric, with the adverse impact of negative shocks by far exceeding the compensatory impact of positive shocks. This is due to various market failures limiting the capacity of the poor to access risk insurance mechanisms. The result is a risk minimising attitude of the poor, limiting investment and slowing down economic growth. (LEDERMAN & MALONEY, 2003; GUILLAUMONT, 2005) confirm that lack of human capital and vulnerability to external shocks are statistically significant structural impediments to growth. By correcting market failures and enhancing resilience to external shocks, anti-cyclical foreign aid can be a very effective instrument to fight vulnerability.

It is therefore reasonable to pay particular attention to countries which are prone to exogenous shocks, notably small and island economies (EU, 2005b). However, due to time lags, donor responses to such shocks are often pro-cyclical and therefore ineffective if not detrimental. Moreover, even anti-cyclical budget support can only be effective if economic governance is satisfactory. As shown by (GUILLAUMONT, 2005) efficient aid responsiveness to exogenous shocks may prove a far more powerful explanatory variable of aid effectiveness than policy performance³².

Catastrophic shocks and political crises³³ are per definition hard to foresee or to integrate in an ex ante aid allocation model. It is therefore more important to build in sufficient flexibility in order to allow for quick, anti-cyclical interventions in case such shocks occur rather than to foresee ex ante allocations for speculative future events³⁴.

However, some countries have small and undiversified economy and/or are prone to natural disasters and dependent on some climate sensitive primary commodities or services (tourism) in a highly volatile international market and are confronted with a high, structural, level of economic volatility. Similarly some countries have a historic record of social and political instability. This past instability may lead to a higher than average risk aversion and lower

³¹ (LEDERMAN & MALONEY, 2003) confirm that it is not natural resource abundance, but macroeconomic volatility due to excessive dependence on some products, whatever their nature, which hampers growth. Short term primary commodity price and/or production booms for example do not automatically translate into sustained increases in income due to a weak capacity to manage macroeconomic volatility and a natural tendency to overestimate the sustainability of booms and subsequently of the sustainable external debt capacity of a country.

³² Using similar aid effectiveness measures as (BURNSIDE & DOLLAR, 1997) and (COLLIER & DOLLAR, 2004), (GUILLAUMONT, 2005) concludes that aid effectiveness is more strongly correlated with vulnerability than with the quality of governance and institutions.

³³ (COLLIER & DOLLAR, 2004) admit that a “security-efficient” allocation of aid and conflict preventive aid is unfeasible as there are no reliable conflict risk models available to date. See also (VAN DE WALLE, 2005).

³⁴ As shown by (COLLIER & HOEFFLER, 2004), the post-crisis aid absorption cycle is long enough to allow for a programmed approach to aid between the initial emergency and LRRD phase and the development phase.

investment rates. Above and beyond the flexible response mechanisms to exogenous shocks, it may therefore be justified to complement the needs-driven approach to aid allocation in order to take into account structural vulnerability.

1.4. Statistical methodology

The (EU, 2005b, §64) has committed itself to the “use of standard, objective and transparent resource allocation criteria based on needs and performance”, although they may be complemented to take into account specific circumstances. This implies among others

- that the information is quantifiable in an objective and verifiable way and that what can theoretically be conceived in a measurable way, can also be compiled at a reasonable cost;
- that the data thus compiled cover most ACP³⁵, are reasonably reliable and comparable across countries;
- that the data are open for external scrutiny and made accessible in a transparent way and not kept confidential³⁶.

The aid allocation criteria also need to be consolidated in a consistent way.

- Discretionary approaches based on categorisation of countries in clusters lead to threshold or border problems and excessive sensitivity to category changes³⁷. We therefore in principle³⁸ seek indicators which can be declined on a continuous basis (FENG, 2003);
- Data are all normalised as a coefficient fluctuating around “1”, so that no scale problems arise and the weighting of each individual indicator in the consolidated aid allocation criterion is ensured by the range of fluctuation allowed around this neutral reference point;
- Where there is a mutually reinforcing interaction between indicators, multiplicative consolidation formula are preferred above additive approaches³⁹.

In addition it is important to select variables which reflect the Community’s development priorities and whose interpretation is unambiguous. The composite indices used to measure economic and political governance in general do not comply with this yardstick:

³⁵ Exhaustive coverage may be unfeasible, especially in small or conflict prone countries with limited data reporting capacity. In those cases, a coherent, pre-set methodology will be proposed for the extrapolation of missing data (see Annex 6).

³⁶ The detailed data of the much referenced “Country Policy and Institutional Assessment” (CPIA) of the World Bank are not yet publicly accessible, although the World Bank announced a change in its confidentiality policy before the end of 2005 (IDA, 2004).

³⁷ In such cases a relative improvement in an aid allocation criterion may result in an absolute decrease in the aid allocated, creating an important disincentive for improvement in the development indicator concerned.

³⁸ However, dummy’s are used where the Cotonou Agreement explicitly requests a special attention for some categories of countries: the landlocked and island states and the least developed countries.

³⁹ Multiplicative formula are also more sensitive to a change in any single variable, facilitating consolidated sensitivity analysis (WATSON, 2005).

- Data of a very different nature are aggregated on the basis of an arbitrary weighting, raising problems of endogeneity, of lack of specificity and ultimately of interpretation of the causes of their change over time and across countries⁴⁰;
- Some well-known composite indices (GWARDNEY & LAWSON, 2004; MILES, 2004) are based on a biased, restrictive view on the role of the Government in the economy and give a very strong emphasis on economic freedom; the problem is that other indices in turn rely at least partially on these biased indices, including the World Bank's "Country Policy and Institutional Assessment"⁴¹.

Rather than to pretend to be able to capture all the nuances of effective political and economic governance in quantifiable "standard, objective and transparent" criteria which go beyond the formalism of complying with procedural governance indicators⁴², it may therefore be methodologically preferable to accept the limitations of a quantitative approach and reject the use of this kind of composite indices. However, if the relevance and importance of these factors which can not be entirely measured by quantitative, standardised tools is confirmed, this may lead to an aid allocation process in two steps: a first one based on a quantitative, standardised approach, followed, on the basis of an assessment of more country or region specific governance issues, by a correction reflecting a more contractual approach to aid allocation. In order to guide this second step, an evaluation grid will be required identifying the major issues to be assessed in order to ensure an objective and transparent process and a constructive dialogue with the partner country, maximising the ownership of the process.

⁴⁰ (KAUFMAN e.a., 2004) consolidates 25 data sources (covering a widely variable range of countries) constructed by 18 different organisations, based on polls of experts, surveys of targeted publics (business people...), commercial rating agencies, other indices..., reflecting various qualitative dimensions of governance. The justification of relying highly on "experts" opinions is, rightly, that "subjective perceptions of governance often matter as much as the legal reality". However experts often suffer from herd behaviour, average score bias (and the IDA's decision to go public may reinforce the tendency to "prudence", especially in a context where the World Bank's statutes prohibit explicit political considerations) and "short-termism", while the country specific sample size of the surveys (e.g. executive opinion surveys, perceived corruption surveys of Transparency International), in particular in the small ACP, are often too limited to be statistically significant. The end-result therefore becomes difficult to interpret, with important threshold problems due to the limited range of the scores and the categorisation of countries in governance clusters sensitive to even small variations in scoring results. The authors recognise that "all governance indicators, not just the subjective ones we have constructed, are subject to non-trivial margins of error, and that care should be taken in making governance comparisons based on such measures". However, it is impossible to check how wide cumulative individual error margins can become, even after weighting sources by their (estimated) reliability. See also (FENG, 2003; WB, 2005a; AMPROU & CHAUVET, 2004; WATSON, 2005).

⁴¹ Paradoxically, the World Bank now recognises the importance of strong institutions and the role of the State in development (WB, 1997). The strong correlation between those indices (FENG, 2003; COLLIER & DOLLAR, 2004) only gives a false impression of robustness of their outcome, since they have a similar ideological bias and similar methodological weaknesses.

⁴² Some variables integrated in composite indices can be quantified and used as proxy indicators based on multilaterally freely available data. These include some of the quantitative information incorporated in the CPIA index that is based on broader surveys and market assessments (such as the "doing business" data) or entirely market-driven indicators such as the relative size of foreign direct investment which can be used as proxies for the competitiveness (including economic and political governance) of a country.

This two step approach has the added advantage of leading to a better balance between input and outcome indicators⁴³.

1.5. Conclusions

The 9th EDF aid allocation criteria need updating to better reflect the enhanced MDG focus and the aid effectiveness debate and to modernise the methodology.

The starting point is to find the **right balance between a needs versus a performance driven approach**. On the one hand, aid allocation criteria privileging the MDG focus and based mainly on needs may provoke moral hazard, by giving an unintentional reward to bad performance as some countries with a large percentage of the targeted poor may also have a poor track record in terms of policy performance. On the other hand, a harsh selectivity policy at the start of the programming cycle based on past performance would restrict the leverage of a political dialogue aiming at promoting the necessary reforms in those beneficiary countries with a strongly reduced ODA envelope. In this context it is important to remind that decisions on aid allocations should be forward looking, while performance indicators are based on past performance (ODI, 2004) and that to be fair a further distinction has to be made between poor performance resulting from lack of resources and capabilities or from wrong policies and lack of willingness (MORENO & ANDERSON, 2004; COGNEAU & NAUDET, 2004; SACHS, 2005).

To overcome the potentially important trade-off between “performance” and aid effectiveness and to ensure that no donor orphans are left behind, including poorly performing countries, difficult partnerships and fragile States (EU, 2005b), an approach in three steps is proposed for the **programmable funds of the post 9th EDF national indicative programmes**:

- A first step, based on a quantitative aid allocation model and based on “standard, objective and transparent” variables. These variables do not include political performance data and do only incompletely capture economic governance⁴⁴ so that needs are predominant although the impact of performance indicators (financial and social performance and some important dimensions of economic performance) remains significant enough to mitigate moral hazard⁴⁵.
- During the programming process itself, on the basis of the assessment made jointly with the partner country of the major development challenges, the reforms required to attain the MDGs and to bring the country on a path towards sustainable social and economic development, and the measures to be taken in that context to increase the aid absorption capacity and the aid effectiveness, the Commission may propose to top up the initial aid

⁴³ The World Bank CPIA indicator purposely focuses on implemented policies rather than on intended policies and results as those latter may also be influenced by other factors beyond the Governments control (IDA, 2004; AMPROU & CHAUVET, 2004; MILANOVIC, 2005).

⁴⁴ This is not to say that those factors or other, political, strategic or commercial considerations are not relevant or important. On the contrary, the relevance and importance of those elements is without doubt and to a large extent enshrined in the Cotonou Agreement (article 9) as being “essential” (democracy, human rights, rule of law) or “fundamental” (governance). However, their integration in the decision making process should be done in a second, separate step to ensure their privileged status and the transparency in decision making and to be able to quantify the relative weight given to those other dimensions of our development or common foreign and security policies.

⁴⁵ The model and the weights given to the respective variables will be presented in detail in the next chapters.

allocation with an incentive tranche⁴⁶. The single programming document will specify the contractual obligations resulting from this dialogue and identify a set of objectively measurable results oriented and impact indicators.

- The review process foreseen at mid term and at end of term, will allow for an assessment of performance based on this set of targets and may lead to a reallocation of funds or a further topping up.

A second trade-off to be tackled is the one between **predictability** advocated in the aid effectiveness debate (OECD, 2005 and EU, 2005a) and **flexibility** to respond to crisis and post crisis situations, external shocks, new needs or exceptional performance⁴⁷. Flexibility implies the maintenance of significant reserves which is to the detriment of disposable funds for programming and therefore at the cost of predictability.

- In order to avoid discontinuity and to ensure a smooth transition from the 9th to the post 9th, the initial post 9th EDF allocation of **programmable funds for each individual ACP country** will not be lower, on an annual basis, than the initial allocation received under the 9th EDF. This limits the penalising impact of predominantly performance driven selectivity. As the consolidated nominal amount available under the post 9th EDF will be significantly higher than this floor (EU, 2005), updated needs and performance will be fully reflected in the relative level of additional funding obtained. Risk of moral hazard will be further minimised by the flexibility built in the second and third steps of the allocation process.
- The Cotonou Agreement (Annex IV, article 3(2)b) requests an allocation for unforeseen needs, the so-called “**B-envelope**”. Experience under the 9th EDF has shown that it is impossible to predict the unpredictable, despite the use of various vulnerability indices (EC, 2000). The result has been that some B-envelopes have remained unused so far while others have proven under-funded. The revision of the Cotonou Agreement has opened the way for more regular increases in allocations on the basis of special needs or exceptional circumstances (Cotonou Agreement, Annex IV, article 3(5)) while downsizing of allocations remains limited to the mid-term and end of term reviews. In stead of sterilising important amounts in unused B-envelopes, it is proposed to allocate a lower initial B-envelope based on historic data, but which can be replenished annually in the aftermath of the annual operational reviews or in between two reviews on an ad hoc basis, if required⁴⁸. This implies that an intra-ACP solidarity reserve is constituted for the periodic replenishment of the B-envelopes. This solidarity fund will provide to the Commission the flexibility to respond to unforeseen challenges.

⁴⁶ (EU, 2005b) has confirmed the political choice not to abandon fragile states. The initial aid allocation model therefore does not take into account performance criteria linked to crisis or post-crisis situations. However, during the 2nd step of the aid allocation process it can be decided within the framework of the special measures foreseen in partner countries falling under article 96 of the Cotonou Agreement or of other circumstances preventing the signing of a country strategy paper or hampering the aid absorption in a structural way, to transfer part of the initial allocation of programmable funds to the “B-envelope” for unforeseen needs for the funding of emergency actions, or to cut the programmable funds in order not to unduly freeze funds until the mid-term review.

⁴⁷ The Cotonou Agreement as revised in Luxemburg in June 2005 offers enhanced opportunities for flexible programming with the possibility of upward revisions during the annual reviews or on the basis of ad hoc reviews in exceptional circumstances described in articles 72-73 of the agreement (humanitarian and emergency assistance).

⁴⁸ The circumstances for such reallocation decisions will require to be precisely framed and benchmarks identified to help determine the amounts involved in light of the intensity of the shocks and unforeseen needs and the capacity of each country to respond so that the political decision making process is made as transparent as possible.

- Building on the contractual approach based on incentive tranches, a further reserve is proposed to top up the programmable funds at national and regional level in cases of **special needs and exceptional performances**. This can be the case in situations whereby a country gets out of a crisis situation and/or manages to significantly increase its aid absorption capacity due to a dramatic improvement in economic and political governance. Similarly, this reserve can be used to oil the mid term review exercise which under the 9th EDF was a zero sum game whereby good performers could only be rewarded by taking away funding of lesser performers. Withdrawing funding from low aid absorbers will remain possible but it will now be possible to conduct the mid-term performance assessment in a more constructive, incentive based context. However, the two-steps programming process allows for a better anticipation of performance until mid-term review which minimises the special needs and exceptional circumstances. The incentive reserve therefore can be limited to an amount within a 5-10% range of the programmable funds, optimising predictability and flexibility.

2. Needs

Needs have two dimensions, one is the size / extension of the needs, the other the depth of the needs. To measure the extension of the needs, the total population is the best starting point, even though dynamic and distributive corrections have to be built in. Regarding the depth of the needs, income (corrected for purchasing power) is usually taken as starting point even though needs cannot be narrowed down to the financial means but refers to a much broader concept of capability to confront poverty, which takes into account “intrinsically” important deprivation constraints (health, under-nourishment, illiteracy) (SEN,1999) and the uneven distribution of capabilities which may even be stronger than income inequality.

2.1. Population and income par capita

2.1.1. *Population*

Population is the standard indicator used by all donors to measure the size of the needs. However, in general, population is giving a non-linear weighting, decreasing with the size of the population. This can be rationalised on several grounds:

- **Economies of scale:** each sovereign state wishes to offer a minimum set of services to its population, some of which have important overhead costs and important economies of scale. Some countries may not even have the minimal size to justify the independent supply of some services such as tertiary education or referral health services, requiring expensive transborder arrangements. Everything else being equal, the share of public administration in GNP therefore tends to evolve inversely with population size. On the opposite side of the spectrum, economies of scale level off in larger, continental countries, when increasing inland infrastructure costs, urban congestion and pollution neutralise scale economies. However, the trend does not need to be reversed as very large

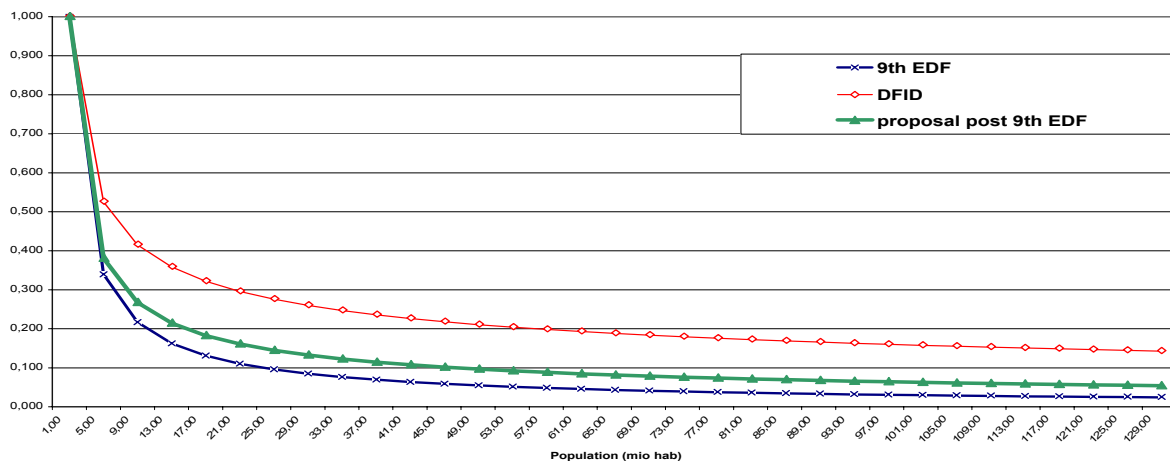
countries, at similar average levels of poverty, have easier access to the international capital markets and therefore are less dependent on concessional aid.

- **Vulnerability:** there is a statistically significant and strong correlation between the size of an economy and its vulnerability to external shocks (GUILLAUMONT, 2005; RADDATZ, 2005). Small economies are less self-sufficient and more open to the world economy, making them more dependent on the world business cycle. Their vulnerability is further exacerbated by the fact that their economies very often are less diversified and therefore have less built-in stabilisers. And finally, many small countries are concentrated in regions prone to natural disasters which, when they hit those states, may impact on a far greater share of the population and of the economy than in a larger state where population and risks are far more scattered.

Under the 9th EDF, population size was weighted by its natural logarithm as from a minimum population level of 1,5 million people (EC, 2000). This however leads to an extreme underweighting of very populous countries (MCGILLIVRAY, 2003; COLLIER and DOLLAR, 2004). To take an illustrative example, Ethiopia, with an estimated population of 69 million people and high poverty levels, everything else being equal received per capita aid equal to only 5% of what Guinea-Bissau at a similar development level but a population of less than 1,5 million people received under the 9th EDF scenario.

Various multilateral or bilateral donors nowadays opt for a less penalising weighting by a power function between 0,5 and 1, with DFID and the Asian Development Bank using power 0,6 (WATSON, 2005; DFID, 2003). In our example above the DFID approach would reduce the gap between Ethiopia and Guinea-Bissau from 1/20 to 1/7.

Theoretical scenarios to weight population



Everything else being equal, the DFID approach would lead to a disruptive result in comparison to the 9th EDF, with a significant increase in aid allocations to the 3 most populous ACP countries, Nigeria, Ethiopia and Congo, mainly to the detriment of middle-sized countries. In order to ensure minimal continuity with the 9th EDF, we propose a power function with coefficient 0,4, while at the same time lowering the threshold from 1,5 to 1,0 million inhabitants. In our example, this would mean that, everything else being equal, Guinea-Bissau should receive

a weighting of approximately 80% and Ethiopia a weighting of nearly 8%, reducing the relative gap measured in aid per capita from 1/20 to 1/10 before further corrections.

(1)	$P^c = 1$ $P^c = P^{0.4}/P$	for $P \leq 1$ for $P > 1$, range [0,0516 – 1,0000]
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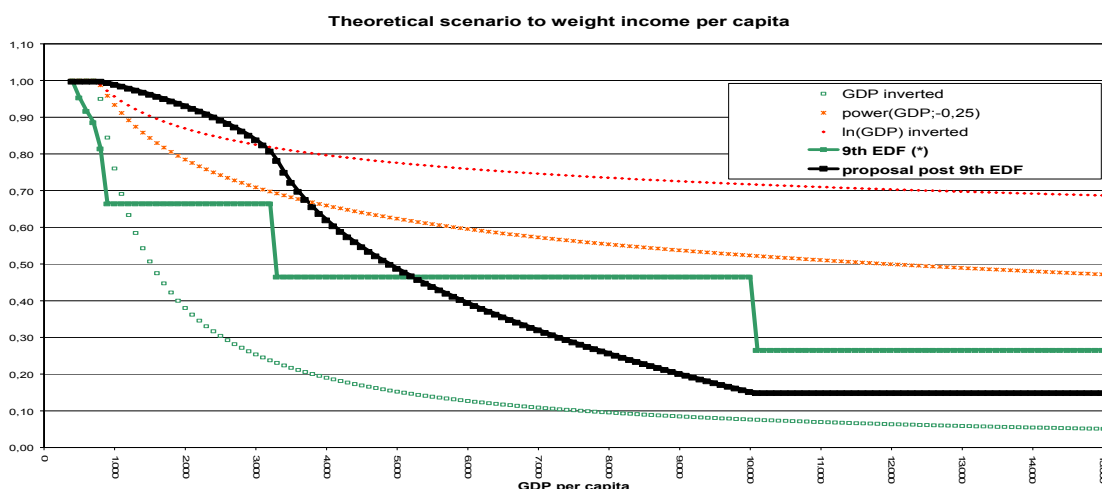
P = total population (in million) (2004)

P^c = population correction coefficient for economies of scale (0,0516 for Nigeria, the most populous ACP country)

2.1.2. Income per capita

The more means a society produces on an annual basis, the more resilient it becomes to external shocks and the less concessional external assistance is required. The starting point to measure means is the Gross Domestic Product (GDP)⁴⁹ at purchasing power parity (PPP)⁵⁰.

As for the population variable, GDP should be given a non-linear, decreasing weighting⁵¹. However the scaling of the weighting is inverted in this case. At low income and lower middle income levels, countries remain very constrained and fragile and per capita aid should only decrease slowly. The decrease in per capita aid should only become more significant for countries entering a more stable take off phase, with an increasing capacity to mobilise domestic savings and an easier access to international capital markets, to converge to zero once the high income country stage has been reached.



(*) including the income related dummy for country status used for the vulnerability index

⁴⁹ Although GNI may better reflect the real purchasing power of a nation, GDP is here preferred to GNI. GNI takes into account transfers (including ODA which pollutes the aid allocation criterion) which are less reliably measured and are more volatile. GDP does reflect the domestic economic structure and the resulting capacity for sustainable development.

⁵⁰ (TAYLOR, 2004), while acknowledging the limitations of the PPP approach (traded goods bias; lagging convergence patterns) confirms that in the long run relative PPP convergence holds, making it a more relevant relative measure of capability than GDP at nominal exchange rates.

⁵¹ Under the 9th EDF, following formula was used: : $GDP_{cap} * [1 + 0,2 * \ln(1/(GDP_{cap}/1000))]$ for countries with ($GDP_{cap} < 760USD$), a coefficient 1 for the other countries, to which a vulnerability dummy was added: +20% for LDCs, -20% for high MICs and an ad hoc treatment of -40% for Barbados and -70% for the Bahamas. The resulting impact has been transposed to the scaling system above for comparison purposes.

Usually the sliding scale is measured either as an inverse function of GDP per capita or of a logarithmic function of GDP per capita (WATSON, 2005). As following graph illustrates, this approach penalises the LIC and the LMICs in a disproportionate way while levelling out the impact of further rises in per capita income. We therefore propose an alternative function whereby the impact of income is limited in the beginning⁵², accelerates when reaching the higher end of the LMICs, to phase out gradually when entering the HMIC level, where aid may still be justified to fight pockets of poverty and/or to maintain an entry point for political dialogue on governance and structural reforms.

The baseline income criterion for the post 9th EDF is based on following thresholds (WB, 2005):

- no sliding scale for LICs, i.e. aid per capita remains constant for all countries with a per capita income at purchasing power parity of less than US\$ 825;
- slowly accelerating sliding scale until the income corrector reaches the value of 0,8 when the HMICs threshold is reached;
- decelerating phasing out to until the point where per capita GDP^{PPP} reaches the HIC threshold, at which stage the income corrector equals 0,15.

(2)	$Y^c = 1$	For LICs ($Y \leq 825$)
	$Y^c = -[(0,4/(3600-825))^{1/3} * (Y-3600)^{1/3} + 0,6$	For LMICs, range [0,80 – 1,00]
	$Y^c = -[(Y-2950)^{1/3} / (10066-2950)^{1/3}] + 1,15$	For HMICs, range [0,15 – 0,80]
	$Y^c = 0,15$	For HICs ($Y > 10066$)

$Y = \text{GDP}^{\text{PPP}}$ per capita, with $\text{GDP}^{\text{PPP}} = \text{GDP}$ at purchasing power parity (2004 data)

$Y^c = \text{GDP}^{\text{PPP}}$ per capita correction coefficient, (scaled between 0,15 and 1)

825 = (WB, 2006) LIC upper ceiling

3255 = (WB, 2006) LMIC upper ceiling

10066 = (WB, 2006) HMIC upper ceiling

2.2 Other needs indicators

2.2.1. Demographic dynamics

As the aid allocation criteria cover a prospective period up to 2013, a correction to the population index is proposed to take into account the dynamics of demography: high population growth and young populations directly increase the MDG challenges through the increased pressure on the educational and health system and the additional costs of enhanced rural-urban migration and accelerated urbanisation⁵³. The most straightforward way to take into account the impact of the demographic factor on the size of the needs over the next programming cycle, is therefore to take into account the relative share of the young in total population. The population variable corrected for impact of demographics:

⁵² For LICs this approach has a very similar impact as (IDA, 2004a) which uses a only slightly sliding scale income variable ($\text{GNI}_{\text{cap}}^{-0,125}$) for IDA eligible countries ($\text{GNI}_{\text{cap}} < \text{USD } 895$).

⁵³ There are also indirect effects slowing economic growth. (KÖGEL,2005) finds a statistically significant negative correlation between youth dependency ratio and economic and productivity growth through its negative impact on the savings rate. See also (FENG, 2003) and (RAVAILLON, 2005).

(1a)	$P^c = P^c * [(1+P_{<15})^{1/2} - 0,095]$	Range [1,00 – 1,13]
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$P_{<15}$ = share of the population younger than 15 in total population
 $(1+P_{<15})^{1/2} = 1,095$ for Barbados which has the lowest youth dependency ratio among the ACP. By subtracting 0,095 from the formula, we normalise the data which then fall between 1 (no correction for demographic growth) and 1,13 (for Uganda, having the youngest population in the sample)

2.2.2. Prevalence of HIV/Aids

The fight against HIV/Aids diverts considerable means as the pandemic threatens the social fabric of society, sweeping out a sizeable part of the economically active population before the social capital invested has given its full return, inducing huge additional costs (social costs resulting from enhanced health and social security expenses, economic costs resulting from lost production factors and dynamic costs of lost confidence in the future).

It is therefore proposed to correct the income variable to reflect the additional costs to society resulting from the HIV/Aids pandemic which in turn decreases means available for other development challenges:

(2a)	$Y^c = Y^c * (1+H)^{1/2}$	Range [1,00 – 1,18]
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H = HIV/Aids prevalence in the 15-49 year group
HIV/Aids prevalence is taken into account in a slightly non-linear way, reflecting economies of scale, in particular in the HIV/Aids prevention campaigns, reducing extreme values to a maximum correction of 18% for Swaziland.

2.2.3. Social development

The most direct way to measure the dept of poverty and subsequently of the means required to fight poverty is to take the proportion of the population living below the poverty line. However, as explained in the introductory part, the means for development cannot be reduced to their financial dimension alone or to the production capacity of society as captured by the GDP concept; development is also hampered by lack of social capital which prevents people to invest in development enhancing measures or to access social services even when formally they are freely available (SEN, 2000). Furthermore reliable data are missing in more than half of the ACP on people living below an absolute level of poverty expressed in monetary terms or on income inequality (WB, 2005). Social development indicators may therefore prove to be more accurate and powerful indicators of poverty and of its breaks on sustainable growth and development.

The key factors of social capital are good health and formal education which arm people to face the modernising society and the globalising economy⁵⁴. And once social capital has been acquired it is important to be able to exploit it throughout productive age.

The way social capital develops is of course heavily influenced by policy choices and therefore by governance issues and performance. However, the starting stock of social capital has an impact on the capacity and quality of governance and therefore on performance prospects over

⁵⁴ As further elaborated under the following point, well development human capital also enhances resilience to external shocks (LEDERMAN & MALONEY, 2003; DERCON, 2005).

the medium term of the post 9th EDF multi-annual financial framework. While under the performance heading indicators will be identified measuring the quality of social policy and progress towards social objectives, at this stage we focus on the initial stock of social capital, or rather, from a needs perspective, lack of social capital. “Social deprivation” handicaps development perspectives and therefore justifies the mobilisation of additional resources to overcome this obstacle.

As starting point we use the **UNDP human poverty index for developing countries (HPI-1)**, measuring the proportion of people that do not meet minimal levels of human development. This measure is a good proxy for the proportion of people below the poverty line.

(3)	$S^{nc} = (1 + HPI_{-1})^{1/2} - 0,0122$ $HPI_{-1} = \{1/3 * [(P_1)^3 + (P_2)^3 + (P_3)^3]\}^{1/3}$	Range [1,00 – 1,27]
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S^{nc} = social needs corrector, fluctuates between 1 and 1,27 (Burkina Faso)

P_1 = probability at birth not to survive beyond 40⁵⁵

P_2 = adult illiteracy rate

$P_3 = 1/2 * (Wa + ^{-5}Uw) =$ deprivation indicator

Wa = % of people without access to improved water source

^{-5}Uw = % of moderately or severely underweight children under 5 years old

While negatively correlated to GNP^{PPP} per capita, there are important shifts in ranking (UNDP, 2004), confirming that for similar income per capita levels, the social capital stock and therefore the development prospects are not necessarily comparable. Adding social deprivation as corrective aid allocation criterion therefore seems justified.

Until 2007 several food insecure ACP countries will continue access general budget resources to set up programmes to fight food insecurity. These programmes are only imperfectly mainstreamed in the country strategy papers and national indicative programmes. The Paris Declaration (EU, 2005), the European consensus (EU, 2005b) and the financial perspectives (EC, COM,2005,324) have all emphasised the need for a more integrated approach based on geographically focused development programming. The Commission proposes to maintain a food security budget line but which will no longer contain a geographic component for structural support to food security policies in individual developing countries. To ensure that these additional needs resulting from structural food insecurity are taken on board when the post 9th EDF funds are allocated, it is proposed to correct the social development variable.

The UNDP human deprivation index takes on board (but with a modest weighting) the broader measure of moderate and severe malnutrition. What is sought here is to identify structural food insecurity problems which need to be tackled in a programmed way and which go beyond seasonal and punctual problems that will continue to be taken care of through other instruments. The prevalence of severe malnutrition is used as a proxy to identify the importance of structural food insecurity.

(3a)	$S^{nc'} = S^{nc} * Fi$ $Fi = (1 + ^{-5}Usw)^{1/2}$	Range [1,01 - 1,35] Range [1,00 – 1,08]
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$S^{nc'}$ = the social needs corrector enhanced by an increased weighting of malnutrition

Fi = food insecurity index

^{-5}Usw = % of severe underweight children under 5 years old

⁵⁵ This factor is highly influenced by HIV prevalence, but also by conflict/post-conflict situations and general health and tropical environment related deprivation, thereby reinforcing rather than duplicating other needs-related factors.

2.2.4. Vulnerability

a) growth instability

Various instability indicators are used to measure vulnerability. (RADDATZ, 2005) distinguishes external shocks resulting from the volatility in the international business cycle (commodity price and terms of trade shocks, interest rate movements on the international financial markets) and natural disasters (geological disasters, climatic disasters and human disasters such as epidemics, regional political instability...).

The easiest indicators to track vulnerability are related to measures of dependency of the international business cycle. The OECD/DAC economic vulnerability index used for the 9th EDF, combines population size, the share of secondary and tertiary sectors in GDP, an export concentration ratio, agricultural production instability and export instability. This measure has different weaknesses⁵⁶:

- It gives an equal, arbitrary weighting to the 5 variables;
- While population size is indeed inversely and statistically significantly correlated to vulnerability, this indicator is already taken into account separately;
- The share of the non-agricultural sector in the economy is a weak vulnerability indicator, as manufacturing in an emerging economy often makes intensive use of agricultural primary commodities and may therefore also be sensitive to climatic disasters, while tourism, often an important tertiary activity, in particular in the small island economies, is particularly disaster sensitive⁵⁷.
- Agricultural production instability, export instability and export concentration ratios are highly interdependent⁵⁸.
- The importance of the 4 non-demographic variables is not entirely exogenous as protectionist and rent-seeking behaviour and bad governance have often slowed down diversification and resilience to external shocks⁵⁹.

⁵⁶ (EC, 2000). (GUILLAUMONT, 2005) uses the same basic model, adding a “remoteness index” (see infra) and a “homeless due to natural disaster index” (which may present a huge problem of under-reporting and only measures the consequences of a limited range of natural disasters).

⁵⁷ (CROWARDS, 2000) confirms that tourism growth is a disaster sensitive variable in the short run (years t and t+1) and encounters enormous difficulties in identifying a single acceptable measure of comparative vulnerability, despite the fact of focusing on a particularly disaster prone region.

⁵⁸ (LEDERMAN & MALONEY, 2003) confirm that export concentration, much more than natural resource abundance, is a statistically significant negative determining factor of growth, sensitive to international business cycle movements and terms of trade shocks. Openness to trade (measured in terms of relative level of protectionism against international competition) creates dynamic growth opportunities which enhance the resilience to exogenous shocks, but (measured as the share of exports and imports in GDP) also increases sensitivity to exogenous shocks linked to the international business cycle. While openness to trade in principle has a positive net impact on long term growth, this effect may therefore be mitigated by a high sensitivity to the international business cycle, in particular in small, low income economies with a narrow production structure and high export concentration. As the net balance of openness is unclear and highly interdependent with the size of the economy and the development level which are already taken care of elsewhere, no specific vulnerability indicator linked to openness to trade and trade concentration is retained in the post 9th EDF vulnerability index.

⁵⁹ As has pro-cyclical export-stabilisation aid which may have increased volatility and weakened aid effectiveness (GUILLAUMONT, 2005) or even slowed down economic diversification (WOLF & SPODEN, 2000). In this logic,

At the conceptual level it should be recalled that the purpose of the exercise is not to foresee the unforeseeable and to try to compensate for it. Indeed, funding for unforeseen needs, including external shocks such as short term instability in export earnings (article 68 of Cotonou) and humanitarian and emergency aid (articles 72-73 of Cotonou) are taken care off through not programmable funds (see point 1.5 above). Furthermore, considering the statistically significant correlation between exogenous shocks, population and poverty level, the population and income criteria above already capture a large part of the vulnerability debate. What we try to capture here are the short and medium term consequences of chronic instability on long term growth prospects.

An alternative approach therefore is not to focus on the causes of the shocks but on the consequences. The intensity and the impact of external shocks are indeed in principle reflected in the growth rate of the economy. The volatility in the GDP growth rate could therefore be a useful synthetic indicator of vulnerability⁶⁰. Although the explanatory variables for volatility in GDP growth also include endogenous causes such as political and economic governance⁶¹, we still think that it is a reasonable proxy to identify vulnerability related needs:

- Since there is robust evidence that vulnerability expressed as long term instability in growth affects risk and investment attitudes in the short and medium term, from a needs perspective, past instability, whatever the cause, shall have an impact on the level of growth over the period covered by the post 9th EDF, which is what we want to integrate here; governance related issues will be considered later;
- As seen above, more specific vulnerability indices may have similar, albeit more indirect, problems of interdependence among variables since the capacity of a country to effectively cope with external shocks will also depend on its policies⁶².

it seems better to help countries with weak economic structures (as reflected in low per capita and high poverty levels), regardless of export concentration and volatility, rather than focus on compensations for export instability which may benefit resource rich countries which are, at least potentially, more resilient to shocks resulting from fluctuations in the international business cycle (FOSU & O'CONNELL, 2005). The aim of the transformation of the STABEX into the FLEX system was precisely to move away from export instability to broader macroeconomic management.

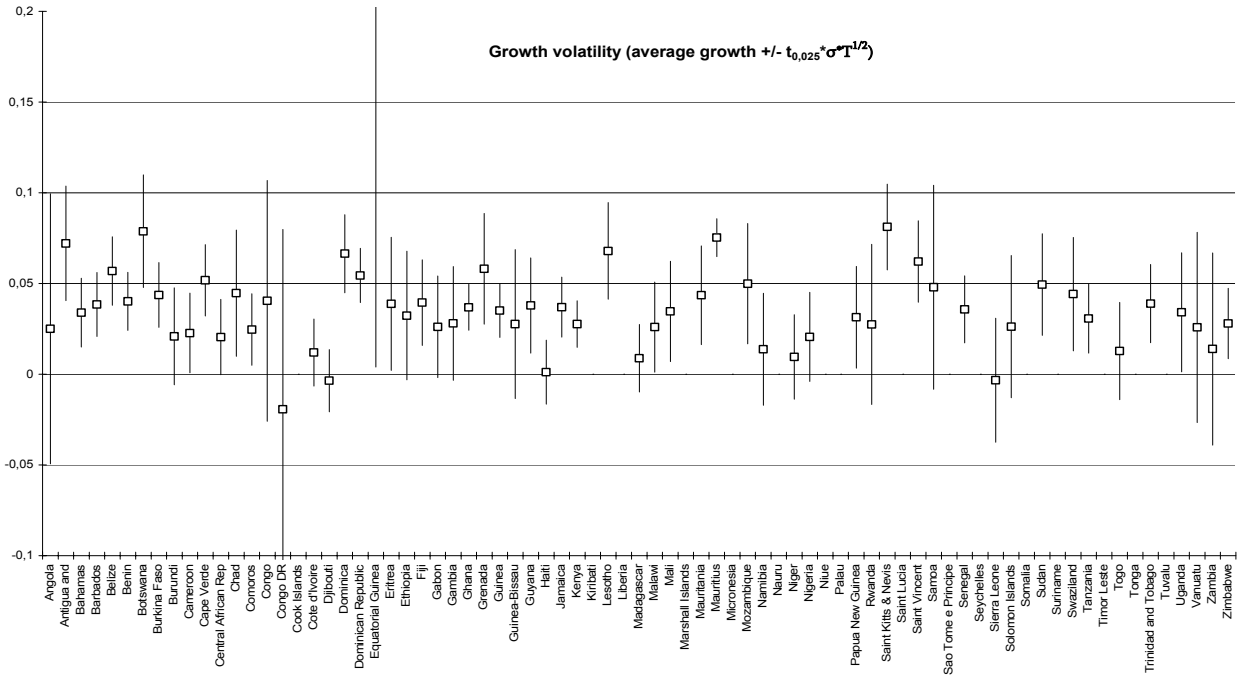
⁶⁰ (ATKINS e.a., 2000) tests income volatility as a function of economic exposure (export dependency and export diversification), remoteness, susceptibility to natural disasters and “others”. Especially when taking a sub sample of small countries, the function became statistically significant. He also confirms that resilience is highly correlated with GDP per capita. (CROWARDS, 2000) finds that GDP growth is statistically significantly correlated with natural disasters, but with a 2 to 3 years time gap because of anti-cyclical external relieve in the short run; over longer time series, income volatility therefore becomes a good proxy for external shocks, even in a disaster prone region.

⁶¹ According to (RADDATZ, 2005), external shocks only explain a small fraction of the output variance in an average low income country. However, he admits that this may to a certain extent be due to the cross-country econometric methodology. The use of dummies does not allow to take into account the intensity of the external shocks, which may also help explain the limited statistical significance of his results. (RODRIK & WACZIARG, 2005) find a sharp fall in the standard deviation of growth after democratisation in time series. To mitigate the moral hazard of compensating for volatility which may result from poor governance, corrective measures must be foreseen under the performance chapter.

⁶² En addition, there may also be reverse causality, whereby external shocks not only impede development but low development levels also enhance the frequency and impact of external shocks by lack of preparedness and mitigation measures. (RADDATZ, 2005; ATKINS e.a., 2000) confirm that sensitivity to human and climatic disasters is closely correlated with poverty levels. As foreseen in the Cotonou Agreement, a special weighting

$(4) \quad S^{vc} = (1 + 2 * t_{0,025} * \sigma_c / T^{1/2}) + C^{LDC}$	Range [1,01 – 1,20]
$\sigma_c = \{ [1/(T-1)] * \sum (G_i - G_{ai})^2 \}^{1/2}$	Range [1,01 – 1,15]

S^{vc} = social vulnerability corrector. It is assumed that extreme growth volatility should be partially offset
 σ_c = standard deviation σ in country c of growth rate around long term (25 years) average growth rate in country c
 $t_{0,025}$ = Student value defining the 95% confidence interval around the average growth rate ($G_{ai} \pm 2,5\%$)
 $2 * t_{0,025} * \sigma_c / T^{1/2}$ = the absolute level of the confidence interval,
 with T = number of years covered (in principle 25 years from 1979-2004)
 with $i = 1 \dots t$ (years covered, t being the most recent year, 2004)
 G_{ai} = average annual growth rate of GDP^{PPP}/capita in country i over period T ⁶³
 C^{LDC} = 5% for LDCs, 0 for other countries



(b) Geographic location also has an impact on development prospects (SACHS, 2005). A basic distinction is made between domestic geography and geographic isolation from the world markets.

- External geographic isolation increases transport costs for goods and services, leads to reduced integration in the world economy and results in a less competitive economy. As such, isolation diverts resources from implementation of development policies to

(+5%) is therefore given to the countries with a LDC status, reflecting in a condensed form structural weaknesses which increase the impact of instability.

⁶³ Theoretically there may be a problem of non-stationarity but this seems limited in practice, at the exception of recent oil exporters for which the start of the oil boom changed their growth pattern, and of some countries emerging from long periods of civil strife with a track record of higher growth rates over recent years. The absence of non-stationarity, even in countries with a marked regime change, relates to differential time lags in measuring the impact of regime and policy changes and the fragile nature of economic recovery in LICs.

increased transport costs⁶⁴. In compliance with the Cotonou Agreement and similarly to the 9th EDF, island or landlocked economy status are being used as one of the indicators of vulnerability but they should be complemented by more refined proxies of costs of isolation⁶⁵. The relative share of freight in import costs for goods is proposed here as a more differentiated proxy: it does not only reflect the relative distance to the major trading partners of a country but also the efficiency of the means of transport utilised (land transport being much costlier than sea transport) and economies of scale in maritime transport (increasing costs for small island economies in comparison to larger island economies)⁶⁶;

- Freight only reflects transport costs up to the point of entry in a country. It is clear that the population settlement profile within a country also has an important impact on the cost and the capacity to supply services to the poor. Low urbanisation levels and low population densities lead to additional costs per person for providing basic social services, both in terms of capital investment and costs of outreach services⁶⁷. These costs are conceptually close to the impact of low absolute population levels which impede the exploitation of scale economies.

(4a)	$S^{vc'} = (S^{vc} + Geo)/2$	Range [1,01 – 1,14]
	$Geo = [(C_{int} + C_{dom})/2] * C^{L/I}$	Range [1,00 – 1,18]

$C_{int} = 1$ if freight costs < ACP average, otherwise

$\{[1+(Fr/M^{fob})] - [1+(\sum Fr/\sum M^{fob})]\}^{1/3}$ = cost of isolation from world markets

M^{fob} = merchandise import free on board;

Fr = freight (transport in commercial service imports);

Fr/M^{fob} = relative share of transport costs in imports as a proxy of the degree of geographic isolation

$\sum Fr/\sum M^{fob}$ = average share of transport costs for all ACP

$C_{dom} = \{[(1+P_r/P_d)]^{1/2}$ = cost of domestic geographic isolation

P_d = population density (population per km²)

P_r = population living in rural areas, proxy for scattered population settlement

$C^{L/I} = (1+0,05)$ for landlocked and insular countries, 1 for other countries

2.3 Consolidation of needs indicators

Needs	$C^N = P^{c'} * Y^{c'} * S^{nc'} * S^{vc'}$
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⁶⁴ The static costs of isolation are reflected in the PPP corrector for the sector of traded goods and services but this corrector does not fully capture the dynamic impact of lower international competitiveness and trade. The “remoteness index” is not conceptually linked to vulnerability to external shocks but to competitiveness vulnerability (see GALLUP e.a., 1998).

⁶⁵ We follow (EC, 2000) by topping up the NIPs with a flat percentage of 5 or 10% for respectively the landlocked or the island states.

⁶⁶ The trade structure may be influenced by transport costs and may therefore be biased (GUILLAUMONT, 2005) but as a “theoretical” trade pattern cannot be built with any greater credibility, relative transport costs are a good proxy for “remoteness”.

⁶⁷ (World Bank, 2005c). Population concentration and population density in turn are influenced by other geographic characteristics (aridity, mountains, tropical climate...). The impact of climate on health or food security is already taken into account in the basic social development indicator. Some geographic factors can neutralise each other (mountainous regions in tropical zone result in a more moderate climate...) and their coherent measuring is still in its infancy (see GALLUP e.a., 1998; SACHS 2005); based on the simplicity rule proposed in point 1.4 they are therefore left out here.

$$NIP_i^N = [(C_i^N * P_i) / \sum (C_i^N * P_i)] * A$$

C_i^N = consolidated needs based aid allocation coefficient

NIP_i^N = A-envelop of national indicative programme for country i based on needs indicators

P_i = population of country i

$\sum P_i$ = total population of ACP group (11,9% increase in comparison to the 9th EDF)

A = earmarked consolidated amount for programmable NIP funding under post 9th EDF

Conceptually the consolidated needs based aid allocation could be further corrected to take into account the specific circumstances of “fragile” states, “failed” states, “post-crisis” states, states in a “difficult environment”⁶⁸. However, the characteristics of each of those states are often very particular and may evolve rapidly in function of various internal and external political and economic variables⁶⁹. Because of the highly politicised environment in which to operate in those countries, the assessment of their particular situation remains subjective. The initial aid allocation model should therefore not take into account explicit “fragile or failed state” criteria, but aid should be modulated on the basis of performance assessment and political dialogue, knowing that aid towards these countries can always be adjusted or complemented through ad hoc reviews or, if based on humanitarian grounds, through B-envelops for unforeseen needs, and this throughout the programming cycle based on articles 3.4 and/or 5.2 of Annex IV to the ACP-EC Partnership Agreement.

⁶⁸ (MORENO & ANDERSON, 2004) presents various definitions of fragile states, while (ODI, 2004) tries to classify them. (COM, 2005,311) defines fragile states as an umbrella concept, regrouping “difficult partnerships” (cases where governments show lack of commitment towards the goal of reducing poverty, weak governance, corruption and political repression, institutions too weak to guarantee people’s security and conditions to live in peace and freedom), countries in crisis or post-crisis.

⁶⁹ (BRANCHFLOWER, 2004) compares “difficult environments” as categorised by various sources, including the Global Development Report on weak states (2004), USA National Security assessments and a list based on the 2 lowest quintiles of the CPIA ratings of the World Bank (World Bank, 2005a) to come to the conclusion that it is paradoxically extremely difficult to come to a consensual shortlist of “core countries”. It appears similarly difficult to come to a shortlist of priority countries for interventions comparing the USA MCA selection with the UNDP list of priorities (see also ODI, 2004; UNDP, 2004). (IDA, 2004c) foresees specific and higher aid allocations during the first 3 post-conflict years with an additional transition to converge to normality after 5 years. (COLLIER & HOEFFLER, 2004) find that the immediate post-conflict absorption capacity is insufficient for increased aid allocation, while additional funding may be justified only after the first 3 post crisis years, and this for a longer transitional period. It therefore seems more appropriate to maintain the normal aid allocation criteria at the start of the aid allocation process and to build in enough flexibility for further increases on the basis of performance throughout the implementation period of the 10th EDF programming cycle as foreseen in the revised Cotonou Agreement.

Indicator	weighting	impact on allocation	maximum range
Basic needs indicators - population - income per capita (at purchasing power parity)		[-95% ; 0%] [-95% ; 0%] [-85% ; 0%]	1/20
Other needs indicators - youth (<15 year) dependency ratio - HIV/Aids prevalence in population (15-49 years) - social deprivation: UNDP human poverty index - probability not to survive beyond 40 years - adult illiteracy rate - population without access to an improved water source - malnutrition: severely underweighted under five children - vulnerability - variance around average annual GDP growth over the last 25 years <i>topping up for LDCs</i> + 5% - geographic isolation <i>topping up for landlocked (+5%) and insular (+10%) countries</i>	[0% ; 13%] [0% ; 18%] [0% ; 27%] [0% ; 08%] [1% ; 14%] [1% ; 15%] + 5% [0% ; 13%] + 5% ou 10%	[-27% ; +13%]	1/21

As can be seen from the above table summarising the weights and the impact of each needs variable in the equation, the basic population and income per capita indicators heavily influence the end result. However, other needs indicators also significantly influence individual country allocations.

- Between the most populous country in the sample and a country with less than 1 million inhabitants, the population factor influences aid per capita within a range of 1 to 20.
- While the income per capita coefficient also has a wide range from 1/7, its combination with the population indicator does not further widen the per capita aid differentiation as all medium and high middle income countries and high income countries concerned are small to very small and fall in the upper segment of the population function.
- The other needs indicators have a significant corrective impact. Being a zero sum game, the countries most in need see their theoretical share in the overall envelop increase with up to 13%. This should be to the advantage of most drought prone middle-sized countries from the Sahel and the South African drought belt, but also wealthier countries which particularly suffer from HIV/Aids and relative geographic isolation. Less needy countries may see their share decrease by up to 27%. These countries are often small and have a higher per capita income but several notorious exceptions (including Nigeria that has a slightly negative needs corrector) confirm that there is no automatic correlation between income and a broader concept of needs⁷⁰. While the overall range does not widen so much, to 1/21⁷¹, the relative share of individual countries does change significantly (Ethiopia moving for example to first rank to the detriment of Nigeria).

⁷⁰ The difference in ranking according to the human development index or the income per capita has been used (including for the 9th EDF) to measure differences in performance. For further discussions see chapter 3 below.

⁷¹ A more disaggregated overview is summarised in annex 3. It should be noted that this range in per capita aid does not yet take into account the minimum aid levels per country fixed for efficiency and scale economy reasons and which, in the micro-states, mainly of the Pacific, inflate the per capita aid and therefore the maximum range even though in absolute terms their impact is marginal.

3. Performance

The principle of introducing performance based aid allocation criteria is based on the assumption that official development assistance (ODA) works better in an environment with relatively sound and/or improving policies and institutions, which may justify a more selective approach.

In this context, it is not so much the baseline level of poverty (needs) but the trends (performance) which we want to capture. As explained in the methodological introduction, performance is the result of both structural impediments and willingness to overcome these constraints through structural reforms. Furthermore, performance indicators necessarily measure past performance and therefore may unduly penalise recent reformers, especially considering the time lags between the start of the reforms and their (measurable) impact. A purely results-oriented approach may therefore lead to the marginalisation of those countries where, despite the efforts made, sustainable results are slow to come (JONES, 2005; COGNEAU & NAUDET, 2004). As the Commission has the ambition to remain present in all ACP countries, including in fragile or failed states, selectivity has to be moderate and should not crowd out the needs-driven criteria, avoiding the “herd effect” on the one side and the “donor orphans” on the other side. This methodological prudence is reinforced by the consideration that performance is a complex issue, imbedded in a local historic context, with widely different starting levels, making progress difficult to monitor in a standardised and quantified way.

However, a minimum set of performance indicators is required to offset moral hazard. In negative terms this can be defined as bad behaviour leading to increased needs resulting in increased aid allocations. But the opposite can be true as well, whereby a positive evolution of an indicator has a net negative impact on aid allocations, creating performance disincentives⁷².

3.1. Aid performance

3.1.1. EC aid performance

For the 9th EDF, aid performance was measured entirely in terms of commitments, based on the commitment level of the 8th EDF at the end of 1999.

As experience shows, aid absorption cannot be measured solely in terms of commitment rates but also needs to be assessed in terms of capacity to implement committed funds. With the introduction of the N+3 rule under the 9th EDF financial regulations (obligation to contract funds within the 3 years following the year of the global commitment of funds) and of the sunset clause (which implies that decommitted funds cannot be recommitted), this has become even more relevant. AIDCO is using the ratio “RAL/disbursements” where RAL (“reste à liquider”) is the stock of committed but so far undisbursed funds. The ratio then measures the number of years theoretically necessary at the present level of disbursements to liquidate all outstanding commitments. Taking a 3 year average to avoid exceptional peaks resulting from the irregular

⁷² (SEN, 1999) writes (p 131): “It is, in general, quite hopeless to look for some indicators that are both relevant for identifying deprivation and – when used as the basis of public support – would not lead to any incentive effect. However, the extent of the incentive effects can vary with the nature and form of the criteria used”. Focusing on deprivation and capability functions therefore is preferred to financial indicators. See also WATSON (2005).

EDF programming cycle, the ratio has declined over the recent years, confirming improved aid delivery since the start of the reforms in 2000, and now stands at 4,37⁷³. The aid performance corrector therefore becomes a combined formula of commitments and disbursements.

(5)	$F^c = (C^r + R^r)/2$ $C^r = \{0,5*[1+(2*C_{05}/A^9)]\}^{1/2}$ $R^r = \{(1+3,5)^{1/3}/[1+(R_{ECT-3}/P_{ECT-3})^{1/3}]\}^{1/2}$	<p>Range [0,81 – 1,19]</p> <p>Range [0,81 ($C_{05} = 0$), 1 ($C_{05}/A^9 = 50\%$) and 1,22 ($C_{05}/A^9 \geq 100\%$)]</p> <p>Range [0,80 ($R_{ECT-3}/P_{ECT-3} > 15$ or < 0), 1 ($R_{ECT-3}/P_{ECT-3} = 3,5$ the targeted norm) and 1,22 ($R_{ECT-3}/P_{ECT-3} = 1$)]</p>
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C^r = adjusted commitment rate⁷⁴

C_{05} = total 9th EDF A envelop commitments, latest available of 2005

A^9 = initial A envelop

R^r = RAL/disbursement ratio

R_{ECT-3} = average RAL over the years 2002-2004

P_{ECT-3} = average EDF payments 2002-2004

3.1.2 Aid dependency

Aid absorption is not only a quantitative concept but also has a qualitative aspect related to aid effectiveness. Aid effectiveness is influenced among others by donor fragmentation which, everything else being equal, increases transaction costs for the beneficiary country. However, this negative relation can, at least partially, be counterbalanced by aid harmonisation and coordination efforts or through integration of aid flows in the national budgets of the recipient countries⁷⁵. Aid fragmentation may also be the result of size or of strong and donor attracting performance which may further mitigate its negative impact. Besides the difficulties of interpreting donor fragmentation, we may also have measurement problems⁷⁶.

⁷³ On the basis of annual data, the RAL/disbursement ratio has decreased to 3,97 and is expected to go down further to close to 3 by 2007 as commitment increases slow down while disbursements continue to rise. The 3 year average RAL/disbursement ratio is expected to fall to 3,5.

⁷⁴ Low income countries under stress (LICUS) and countries in post-conflict situations will by their nature be poor aid performers and should not be penalised for this (COLLIER & HOEFFKES, 2004; ODI 2004; OECD 2005a). This is why a lower ceiling has been put on this variable.

⁷⁵ (OECD, 2005) defines as one of its alignment targets that 85% of aid flows should be reported on the beneficiary's national budget. (EU, 2005) added two complementary targets that 50% of Government to Government aid should be channelled through the country system and that the percentage of our aid provided through budget support or Swap arrangements should be doubled. IDA(2004a) suggests as indicator the share of donor's support linked to explicit PRSP priorities in order to reinforce country.

⁷⁶ The often used Herfindahl index ($1 - \sum S^2$, where S is the share of each individual donor in total aid) is not only influenced by the number of donors but also by their relative importance (KNACK & RAHMAN, 2003; WB, 2004). The result then becomes even more ambiguous as costs of dependency of one or a limited set of dominant donors which do not follow international best practice, may exceed the transaction costs of fragmentation. In that regard (TORSVIK, 2005) comes up with an intriguing game theoretic conclusion that in some circumstances, when donor and recipient country objectives are conflicting (i.e. recipient country's political agenda is less geared towards fighting poverty), donors have incomplete information on the recipient's commitment to reform and aid is fungible (i.e. aid has strong crowding out effects on domestic support to the poor), on the one hand donor fragmentation may weaken their capacity to impose conditionalities but on the other hand donor coordination may in some not unrealistic scenarios enhance the crowding out effect, in particular when donors are needs driven.

On the other hand, supposing declining marginal utility of aid, aid effectiveness may be more significantly affected by the level of aid dependency⁷⁷. The initial aid performance criterion, focusing on EC performance in the framework of the ACP-EC Partnership Agreement, can therefore be nuanced to take into account the overall aid dependency ratio.

(5a)	$F^c = F^c / A_{dT}$	Range [0,80 – 1,17]
	$A_{dT} = (1 + P_{T-3T} / Y_{t-3})^{1/5}$	Range [1,01 – 1,10]

A_{dT} = average total aid dependency ratio over the last 3 years

P_{T-3} = average total donor disbursement over the last 3 years

Y_{t-3} = average nominal GNI over the last 3 years

3.2. Economic performance⁷⁸

Two distinct dimensions of economic performance have to be monitored, (1) investment climate and (2) macroeconomic performance which measures the effectiveness of good governance⁷⁹.

3.2.1 Investment climate

The broader concept of economic governance tries to measure the quality of economic policy making and management. While macroeconomic performance measures the past cyclical behaviour of the economy, economic governance measures the capacity⁸⁰ and determination of Government to undertake structural reforms leading to an investment climate supporting pro-poor growth and development.

As explained earlier, various composite indices of economic and political governance have been constructed which all have the same flaws: variable but overall limited coverage, arbitrary

⁷⁷ The findings discussed by (McGILLIVRAY, 2003 and AMPROU & CHAUVET, 2004) seem to suggest negative returns when aid inflow reaches anywhere between 15 and 45% of GDP, indicating a ceiling in consolidated aid absorptive capacities. This declining marginal utility of aid is one additional argument for dampening excessive selectivity in aid allocation.

⁷⁸ The distinction between economic and political management is sometimes blurred (and the World Bank's CPIA index also includes some indicators with an implicit political dimension even though the World Bank statutes prevents the Bank to tackle political issues upfront) but to simplify the discussion, we will consider the essential elements of the Cotonou agreement as part of political performance (article 9.2, democracy, rule of law and human rights plus, article 11b of the revised text of the Cotonou Agreement, fight against the proliferation of weapons of mass destruction), while the fundamental element of the Cotonou Agreement (article 9.3, economic governance) is treated as economic performance.

⁷⁹ (IDA, 2004), recognising that macroeconomic performance is also influenced by other factors, does not explicitly try to capture this dimension in the CPIA index, thereby implicitly confirming that the link between aid effectiveness and economic performance may be less straightforward than initially thought.

⁸⁰ The capacity of the Government to collect taxes, expressed as a share of GDP, may give a good indication of the capacity of the Government to develop a working relation with the private sector and to mobilise domestic resources for the conduct of its policies; ZAKARIA (2003) considers tax collection as a key test of a government's legitimacy "because it requires not vast police forces but rather voluntary compliance with laws". However, data are patchy and their quality very uneven, and their interpretation more ambiguous than it appears, partially reflecting ideological choices over the role of the state in the economy and economic structure (countries with an important, easily taxable, primary commodities export basis may have a strong hold on income from economic activity despite being vulnerable and having weak governments).

weighting⁸¹, quantitative translation of qualitative assessments with risk of herd effects and of ideological or political bias⁸², confidentiality⁸³, and a narrow range of variation leading to categorisations with increased threshold risks due to high sensitivity to some of the composite variables⁸⁴.

An alternative to a qualitative assessment of the institutional and legal framework and the reforms undertaken to measure the enabling nature of the environment for private sector development and trade, is to look to the results and the impact of this framework and the reforms undertaken. Some indicators can indeed be considered as relatively robust proxies for an economic environment favourable to sustainable (private sector) investment and trade.

Investment climate surveys contain useful information, but the samples remain too incomplete, in particular in the ACP region⁸⁵. One exception is the World Bank's "Doing Business indicators" which measures a limited number of government regulations and their effect on domestic SMEs in a broad range of developing countries⁸⁶.

We therefore propose to use a more limited **investment climate index** as provisional proxy for economic governance, knowing that the mobilisation of the incentive tranche will be discussed during the programming phase on the basis of an additional performance assessment related to, among others, economic governance and the quality of the institutional and legal framework⁸⁷. The selected variables give indirect evidence of the enabling nature of the environment for private sector development:

- Everything else being equal, **openness to trade**, by breaking down private or public monopolies, undermining rent seeking behaviour and creating a more even playing field, is an effective tool for promoting governance (BONAGLIA e.a., 2001), economic growth and economic freedom (GWARTNEY, 2004; World Bank, 2005c)⁸⁸;

⁸¹ Although (IDA, 2004) claims that the results based on statistically derived weights yield "essentially the same results", the problem is that the causes of variation in the index over time cannot be interpreted and that even small changes in appreciation of some variables can have a discretionary impact on the categorisation of countries.

⁸² For that reason the CPIA score may also suffer from conflicts of interest and/or circularity considering that aid allocations are determined by an assessment of merit which is predominantly constructed by the institutions own experts (MOSLEY e.a., 2004).

⁸³ However, the World Bank announced that the CPIA ranking would move into the public domain by early 2006.

⁸⁴ With a global rating scale between 1 and 6, (JONES, 2005) finds that the average score (based on 2003 CPIA classification) varies between 2,58 for the lowest quintile of countries and 3,69 for the highest quintile, with the majority of countries in the "moderately weak" range, which makes it very difficult to build in robust differentiation thresholds. Going public will probably further enhance the tendency to median scoring.

⁸⁵ In addition, investment climate surveys present the same limitations linked to the consolidation of answers to a wide variety of questions in one single figure, reflecting more a general climate, correlated to macroeconomic performance, than highlighting specific constraints.

⁸⁶ (WB, 2005d) shows that excessive regulation slows growth (even when controlled for income and human capital variables) without improving social protection and therefore is negatively correlated to the UNDP Human Development Index. The data cover 7 indicators, of which 3 are very incomplete and/or based on experts judgment (index of borrower and lender legal rights, rigidity of employment and investor disclosure index), while 4 others measure the time required to respectively start a business, registering property, enforcing contracts and resolve insolvency at the closure of business.

⁸⁷ For the 9th EDF, a mainly discretionary and procedural approach was adopted, linking the economic performance corrector to the existence of a structural adjustment programme with the IMF and the period that EC funded structural adjustment facilities have been off track during the period 1991-'99. As SAPs and SAFs are only tools and not a goal per se and the on-off approach did not allow for a qualitative assessment, this approach is deemed unsatisfactory. See (EASTERLY, 2005) about the disappointing impact of repetitive structural adjustment lending.

⁸⁸ Even though some authors (NG & YEATS, 1998; RODRIK e.a., 2002) stress the "primacy" of institutions in development, there is now a broad theoretical consensus that, everything else remaining equal, trade promotes

- The **business environment**, measured by a composite index based on data collected by (WB, 2005d), including the average time needed for domestic SMEs to start a business, register property and enforce contracts (World Bank, 2005d);
- The share of **foreign direct investment (FDI)** in gross capital formation and the share of **gross domestic capital formation** in GDP can be used as proxies for the investment climate and for the legal environment and the rule of law in general (including corruption) as investors seek investment protection and security and are increasingly sensitive to corporate governance⁸⁹.

$(6) \quad I^d = [B_{sme} + 1/(1+NRP_t)]/2 * [(1+FDI_{t-3}/GCF_{t-3})^{1/3} + (1+GDCF_{t-3}/Y_{t-3})^{2/3}]/2 \quad \text{Range: } [0,91 - 1,07]$ $B_{SME} = (2/t_s^{1/3} + 1/t_p^{1/3} + t_c^{1/3})^{1/2} + 0,0389$
--

I^d = investment climate index

B_{SME} = proxy for the business environment for domestic small and medium size enterprises (the 0,0389 is added to allow the index to fluctuate between 0,77 and 1,0 for the country with the most enterprise friendly regulatory environment)

t_s = time required (in days) to start a formal sector business

t_p = time required (in days) to register property

t_c = time required (in days) to enforce contracts

NRP = nominal rate of protection, measured as the mean tariff, weighted by share in imports

FDI_{t-3} = Foreign direct investment over the last 3 years

GCF_{t-3} = gross capital formation over the last 3 years

$GDCF_{t-3}$ = gross domestic capital formation (GCF-FDI) over the last 3 years

Y_{t-3} = GDP in nominal terms over the last 3 years

3.2.2. Macroeconomic performance

Macroeconomic performance can be measured through a limited number of key indicators of macro-economic equilibrium, traditionally inflation, budget deficit, trade balance and debt.

- Data on inflation may be unreliable, especially in weakly monetarised economies with large informal sectors, in particular when fixed exchange rate regimes lead to repression

growth and, through growth, poverty reduction. (JANSEN & NORDAS, 2004) confirms a statistically significant impact of the quality of institutions but also confirms the statistically significant impact of tariffs on trade openness when combined with good institutions (based on the institutional quality indicator from KAUFMAN & KRAAY, 2002). Openness should not be measured as a share of trade in GDP (which is highly dependent on other factors, including exogenous, geographic variables) but in policy terms (weighted average tariff level as a proxy of all trade barriers – see also MILES, 2004). (HINKLE e.a., 2003) shows a strong positive correlation between non-tariff barriers (NTBs) and tariff barriers. (KEE, 2004), measuring what (WB, 2005b) calls the “overall trade restrictiveness index” (OTRI), recognises that countries are significantly more restrictive than their simple or import-weighted tariffs suggest but confirms this strong correlation. (WB, 2005b) further confirms that non tariff barriers are relatively speaking more important in rich countries. Considering the quantity of data required for a reliable estimation of the effective protection rate including NTBs in most ACPs, the weighted mean tariff is used here as proxy for trade openness.

⁸⁹ (KAUFMANN, 2004 and 2004a) confirms a statistically significant correlation between corruption and the World Economic Forum’s Growth Competitiveness Index. Not all FDI contributes to GCF and the measure of GDCF measured as (GCF-FDI) therefore may not fully capture privatisation schemes, mergers and acquisitions and underestimate the dynamics of the investment climate. Similarly, FDI in extractive industries should be filtered out of the data as the mining sector very often operates in isolation of the national economic environment, but we do not have access to reliable disaggregated data.

of inflation⁹⁰, and very often reflect an urban bias. Therefore inflation is not always a strong indicator of internal disequilibrium⁹¹.

- In economies highly dependent on ODA, vulnerable to external shocks, or with weak public finance management and unreliable effective budget data, the relative level of the effective budget deficit may also be hard to compare over countries.
- It is in general difficult to assess the sustainability of a trade deficit which may be caused by cyclically or structurally weak export capacity and/or by a high import demand. If the imports are largely composed of productively reinvested capital goods, even fairly large trade deficits can be sustainable in a growing economy. External debt and external debt service is a more powerful indicator of the global balance of payments situation which, including the capital balance, better reflects international trust and sustainability of the external disequilibrium.

We therefore retain 2 key indicators of macroeconomic performance:

- GDP per capita growth rate over an economic cycle as the most synthetic indicator of macroeconomic performance⁹², and
- the evolution of external debt in order to ensure the long-term debt sustainability of that growth⁹³.

Sustainability of growth performance should be assessed not only in economic but also in environmental terms⁹⁴. Two further indicators are therefore integrated in the equation:

- economic growth may be the result of the exploitation of non-renewable natural resources (oil, mining) which means that part of the rent generated by the extraction of these natural resources should be set aside for diversification and/or as an

⁹⁰ In such cases, the black market premium on foreign exchange may be highly volatile and hard to measure.

⁹¹ This probably also explains why inflation is rarely a statistically significant explanatory variable of growth and development in regression analyses (FENG, 2003).

⁹² (WB, 2005b and WB, 2005c) reconfirm the strong correlation between economic growth and reduction in absolute poverty level even though the sensitivity of poverty to growth has been lower in Sub-Saharan Africa than elsewhere due to low initial levels of income (poverty trap) (SACHS, 2005) and high initial inequality.

⁹³ The evolution of the external debt is not only an indicator of macroeconomic performance but also of governance, as it shows the capacity of the Government to control major macroeconomic variables and, in HIPCs in particular, reflects favourable international assessment of economic performance once the HIPC decision point has been reached and external debt is partially wiped off. The evolution of debt service is more ambiguous as it may not capture the situations whereby a country accumulates arrears on its external debt service.

⁹⁴ Various efforts are being made to help develop a unified indicator of environmental performance. Composite indices, as for economic performance, present the disadvantages of being based on incomplete and uncomparable data-set, in particular in LDSs and, combining so many interdependent, endogenous and exogenous variables that they become extremely complex to interpret, in particular from a policy performance point of view (OECD, 2003a). The often used environmental sustainability index for example (ESI, 2005), is highly biased towards natural endowment, to the detriment of policy related issues. A more modest approach based on the identification of stand alone variables may therefore better suit our goal. However, various indicators currently used are strongly correlated to income per capita and economic structure (e.g. carbon dioxide emissions per capita) or to ecological and climatic conditions (e.g. deforestation) or are formalistic (number of international environmental agreements ratified) and therefore do not discriminate for policy as such.

intergenerational insurance mechanism to guarantee longer term growth, decreasing the real economic growth level⁹⁵;

- economic growth may also be the result of non-sustainable extensive agricultural growth on ever more marginal agricultural ground. An additional corrector for agricultural land use is therefore build in

The conclusions of the mid term review are based on a careful assessment of performance in the light of benchmarks determined at the start of the 9th EDF and of the recent evolution in political and economic governance, including public finance management. An increase in allocation assumed the respect of a minimum set of auditing standards and credible institutional capacity to maintain sustainable pro-poor growth which gives confidence that the incremental aid will be effectively absorbed. The results of the mid term review are therefore introduced as an additional indicator of both economic governance and performance.

<p>(6a) $E^m = \{[1+(\Delta^{t-5}Y^{sust})]*[1 - \Delta^{t-5}D^e * (D^e/Y_t)]^{2/3} * Env\} * (1+MTR)^{1/4}$ $\Delta^{t-5}Y^{sust} = [1+(\Delta^{t-5}Y - I^{NRR})]$ $Env = 1+(AL-1)*Agr$</p>	<p>Range: [0,81 – 1,32]</p>
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E^m = macroeconomic performance indicator

$\Delta^{t-5}Y^{sust}$ = environmentally sustainable growth over the last 5 years (1999-2004)

$\Delta^{t-5}Y$ = average annual per capita growth of GDP^{PPP} over the last 5 years

$I^{NRR} = (NRR^t/Y^t)^2$ = index of average annual natural resource rent, measures in a non-linear way the level of exploitation of non renewable natural resources⁹⁶.

$\Delta^{t-5}D^e$ = average annual evolution in external debt over the last 5 years as % of GDP⁹⁷;

$Env = 1+(AL-1)*Agr$ = measure of environmental pressure through agricultural extension, with a limited fluctuation range between 0,89 and 1,0

where $AL = \{AL_{un} / [(AL_{un}) * (1 + \Delta^{t-5}AL_u)]\}^{1/3}$

AL_{un} = unused arable land

AL_u = used arable land, change over 5 years (1997-2002)

Agr = share of agriculture in GDP

MTR = mid term review reallocations on the A envelope as a share of the initial 9th EDF allocation

3.2.3 Combined economic performance indicator

In combination the macroeconomic performance and economic governance coefficients give the overall corrector for economic performance E^c :

<p>(6b) $E^c = (I^{cl} + E^g)/2$</p>	<p>Range: [0,86 – 1,16]</p>
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⁹⁵ The World Bank has made estimates of the size of the natural resources rent for the period 1997-2001.

Extrapolations for countries benefiting from a more recent oil boom (Equatorial Guinea and Chad) have been made based on the data from Gabon and Cameroon.

⁹⁶ While $\Delta^{t-5}Y$ fluctuates between -5% and +12%, I^{NRR} fluctuates between 0 and 16%, which means that even a very high average economic growth rate may be entirely annihilated and transform good economic performers in poor performers or weak performers in even worse performers as was the case for most oil exporting African countries plus Mauritania.

⁹⁷ The evolution of external debt is calibrated by the present level of external indebtedness to measure the relative impact of the debt evolution on economic sustainability.

The synthetic macroeconomic indicator, being based on passed performance, is calibrated in such a way that it does not have an overwhelming impact on aid allocation at the start of the programming cycle. Specific governance factors will be considered during the programming phase in order to determine a possible incentive tranche, while macroeconomic and sector performance indicators will be further monitored during the implementation phase of the post 9th EDF multi-annual financial framework, allowing for reallocations during mid-term and end of term review in case of weak performance. “Contract terms” will be defined during the programming process so as to increase ownership and accountability.

3.3. Political performance

Political performance should focus on the essential elements of the Cotonou Agreement (article 9): human rights, democratic principles and the rule of law (article 9.2) and the fight against the proliferation of weapons of mass destruction (article 11.b of the revised Agreement)⁹⁸.

As for economic governance, composite indicators transforming qualitative assessments of country specific situations and commitments in quantitative indices only give a false impression of rigour and transparency. Similarly, an approach based on formalistic procedural indicators of democracy and discontinuous regime changes is not retained as it does not necessarily measure real involvement of population in policy making and control⁹⁹. Furthermore, political regimes change and political performance can be even more volatile than economic performance, so that aid allocation should be based less on historic performance and more on the present situation, the reform agenda and its credibility.

We therefore prefer to leave the assessment of political performance entirely open in the initial phase of aid allocation and to tackle this issue in the framework of the programming dialogue¹⁰⁰. Non quantifiable economic, political and social performance indicators will determine the final indicative amount which will be discussed in the appropriate management committee of the

⁹⁸ The development or proliferation of WMD by any recipient country may indicate that the fight against poverty and sustainable development are not prime State objectives, justifying the freezing of all normal cooperation with Government, and maintaining only, possibly, some cooperation in support of the non-state actors for the reinforcement of the essential elements of the Cotonou Agreement through the 15% of the theoretically aid allocation destined for non-focal areas of cooperation.

⁹⁹ Formalistic indicators cannot discriminate between “effective” democracy and what (ZAKARIA, 2003) calls “illiberal democracies” (democracy without liberty) or “semi-democracies”. See also (ODI, 2004) on the distinction between authority, effectiveness and legitimacy. Furthermore, procedural approaches do not easily take into account differential time lag factors (RODRIK & WACZIARG, 2005) and cannot measure the dynamics of democratisation as a process (SEN, 1999), which leads to erroneous conclusions (MULLIGAN e.a., 2004) that there may be no statistically significant correlation between political performance and development. (FENG, 2003) only finds statistical significant correlation and causality links between democratisation and economic and social performance when disaggregating political performance in 3 components (rule of law, stability and certainty, qualifying procedural indicators) and measuring indirect effects, neutralising for interdependence among explanatory variables and reverse causations. See also (WB, 2005a, 2005b).

¹⁰⁰ There is a long tradition linking democracy to social factors and in particular human capital endowment (SEN, 1999; FENG, 2003) although recent research (ACEMOGLU e.a., 2005) questions the robustness of the findings and the causality. Anyway, some social indicators which may also be proxies for Government sensitivity to the essential elements of Cotonou such as gender and the structure of government expenditures are picked up in the social performance chapter.

Council before notification to the ACP partner countries¹⁰¹. This final amount will be based on a contractual approach and may lead to the mobilisation of an incentive tranche or, in specific circumstances such as countries falling under the special measures foreseen in article 96 of the Cotonou Agreement or other fragile states with which under the 9th EDF for example the country strategy paper was never signed for reasons related to the lack of compliance with the essential and fundamental elements of the Cotonou Agreement, to a reduction of the envelope for programmable funds¹⁰².

3.4. Social performance

Whereas social needs were taken into account on the basis of absolute deprivation levels, social performance should be based on progress in reducing poverty and reinforcement of social cohesion.

Social cohesion reflects the capability of people to participate in social life. Income inequality is often used as a proxy for social cohesion. However, income inequality measures such as the GINI coefficient are often missing (WB, 2005) and are notoriously difficult to compare over time and a fortiori across countries, due to non standardised variables (FENG 2003). However this data limitation is not unsurmountable since other proxies can be found to measure the capacity to function in society. Social cohesion should be considered as contributing to substantive freedom (SEN, 1999). Indicators of access to social services tend in fact to demonstrate that income inequality measures underestimate the social cohesion problems¹⁰³.

Two complementary approaches are proposed:

- on the one hand an input based approach measures to what extent the means at the disposal of the Government are geared towards the fight against poverty. In this context, the structure of the budget expenditures can be used as a proxy for pro poor policies¹⁰⁴;
- on the other hand is a results based approach, which measures the progress made towards attaining the MDGs¹⁰⁵.

¹⁰¹ The proposed approach should eliminate more effectively the risk of a statistically significant negative correlation between aid allocation and civil liberties as happened under the 9th EDF (WOLF, 2000, using the Freedom House Index as proxy for civil liberty).

¹⁰² In cases where no strategy paper can be signed, an option remains, if agreed with the member States and in full compliance with the possible “special measures” decided by the Council, to transfer funds to the “B-envelope” for unforeseen needs so as to be able to respond to emergency needs and aid linking rehabilitation and reconstruction to development (LRRD).

¹⁰³ Unequal income leads to unequal bargaining power and higher unit costs of consumption and financial services, a weaker political voice and therefore unbalanced prioritisation and unequal provision of public goods (SEN, 1999; WB, 2004). (FENG, 2003) also found that income inequality and social inequality are statistically significantly correlated to political predictability (“shared growth” theory).

¹⁰⁴ In this regard it is not the level of “pro-poor” public spending (even controlled for income) which is relevant but the relative attention to social sectors and within social sectors to primary service delivery (MOSLEY e.a., 2004; WB, 2004; WB, 2005b). (MOSLEY e.a., 2004) confirms that pro-poor expenditures, together with inequality and corruption (which weakens the effectiveness of the invested funds) are key determinants of the poverty efficiency of aid. Ideally the shift in expenditure patterns should be measured but there are not enough reliable data on the evolution of effective expenditure over time to be used in the model.

¹⁰⁵ (UNDP, 2004) measures progress towards MDGs as the differential between the actual rate of progress and the required annual rate of progress (both calculated as an arithmetic average): $[(x_t - x_0)/x_0]/(t_t - t_0)$ or $[(x_t - x_0)/(100 - x_0)]/(t_t - t_0)$ according to the type of indicator compared to $[(x_t - x_0)/x_0]/(t_t - t_0)$ or $[(x_t - x_0)/(100 - x_0)]/(t_t - t_0)$ where

(7)	$S^{pc} = (G^c + E^c + H^c) / 3$ $G^c = [(G_s - G_m) / G_s]^{1/2} * G_{pe}^c$ $G_{pe}^c = [(1 + G_{pe} / G_e) * (N_e) * (N_e / N_g)]^{1/3}$ $E^c = [1 + (N_{eg}^{2003} - N_e^{1990})] / [1 + 0,5 * (1 - N_e^{1990})]$ $H^c = [0,8667 - 0,5 * (-2/3) - (.5MR^{2003} - .5MR^{1990}) / .5MR^{1990}] / [0,8667 - 0,5 * (-2/3)]$	Range [0,80 – 1,20] Range [0,77 if $(G_s - G_m) / G_s < 0 - 1,24]$ Range [0,72 if $(N_{eg}^{2003} - N_e^{1990}) < 0,9$; 1,12 if $N_{eg}^{2003} = 1]$ Range [0,90 if $.5MR^{2003} > .5MR^{1990}$; 1,29]
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G^c = corrector for share of social sectors in public expenditure compared to military expenses

G_s = public expenditures in social sectors (health and education)¹⁰⁶

G_m = security related public expenditures (military, security, presidency)

G_{pe}^c = share of public expenditure on primary education in total education budget, corrected for efficiency indicators¹⁰⁷

G_{pe} = public expenditure on primary education

G_e = public expenditure on education

N_e = net enrolment in primary education

N_g = gross enrolment in primary education

E^c = MDG corrector for progress towards universal primary education by 2015

N_{eg} = net enrolment in primary education corrected for gender inequality

= $N_e * (G_p / B_p)$, with (G_p / B_p) = ratio of girls/boys in primary education =

H^c = MDG corrector for progress towards reducing under-five mortality rate by two third between 1990-2015¹⁰⁸

$.5MR^t$ = under five mortality rate in year t

As pointed out at the start, the incentive structure has to reward good performance. Progress to attaining the MDGs has been very weak, and in various cases the social indicators have even deteriorated between the start of the reference period and 2003. Therefore, the social performance indicators have been calibrated in such a way to remain within a reasonable interval. The consolidate social performance indicator S^{pc} fluctuates between 0,8 and 1,2¹⁰⁹.

3.5 consolidation of performance indicators

Performance	$C^P = F^c * E^c * S^{pc}$	Range [0,69 – 1,34]
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C^P = consolidated performance based aid allocation coefficient

t_0 = 1990 or the nearest figure, t_i = most recent information and t_t = 2015; $(x_t - x_0) / x_0 = -1/2$ for poverty/hunger component; $1/2$ for water/sanitation; $-2/3$ for infant mortality rate and 1 for primary enrolment/gender equality in education.

¹⁰⁶ In various countries, the private provision of social services is significant but worsens social inequality. We therefore focus on the role of Government in providing the basic social services.

¹⁰⁷ The discrepancy between net and gross enrolment rate can be large, which is an indicator of inefficiency in education.

¹⁰⁸ (UNICEF, 2005), considers infant mortality rate as the most reliable indicator, as well of investments made in child welfare as of their results.

¹⁰⁹ (UNDP, 2004) constructed a gender related development index which however is difficult to replicate due to unreliable and missing data and which also reflects past performance rather than present policies (the education component for example includes differential adult literacy rate). As gender in primary school enrolment is a strong gender and development indicator, it was considered a good proxy for our purpose.

Performance varies far less than needs overall, but within a comparable interval as the needs variables other than population and income per capita. The impact of the performance indicators on the aid allocation based on needs falls within the [-29%; + 40%] range.

Indicator	weighting	impact on allocation
Performance criteria		[-29% ; +40%]
- financial performance	[-20% ; +17%]	
- Community aid performance	[-19% ; +19%]	
- aid dependency	[-11% ; 0%]	
- economic performance	[-14% ; +16%]	
- sustainable economic growth	[-19% ; +32%]	
- investment climate	[-9% ; +7%]	
- social performance	[-20% ; +20%]	
- public expenditure structure (health+education / military)	[-23% ; +24%]	
- progress towards primary education for all (corrected for gender + efficiency)	[-28% ; +12%]	
- progress towards a reduction in infant (under five) mortality rates with 2/3	[-10% ; +29%]	

4. Conclusions

NIP	$NIP^{N+P}_i = [(C^{N+P}_i * P_i) / \sum (C^{N+P}_i * P_i)] * A$
EDF9 ^e _i	$EDF9^e_i \leq NIP^{N+P}_i \leq 1,5 * EDF9^e_i$

NIP^{N+P}_i = post 9th EDF A-envelop (programmable part of the national indicative programme) for country i based on needs and performance indicators

$$C^{N+P}_i = C^N_i * C^P_i$$

P_i = population of country i

A = earmarked consolidated amount for programmable NIP funding under post 9th EDF

EDF9^e_i = initial 9th EDF A-envelop allocation for country i extrapolated over 6 years (+20%)

NIP^{N+P}_i = the initial indicative post 9th EDF A-envelop communicated at the start of the programming process on the basis of the quantitative model

4.1 Weighting of the needs and performance indicators ¹¹⁰

Indicator	weighting	impact on allocation	maximum range
Basic needs indicators		[-95% ; 0%]	1/20
- population		[-95% ; 0%]	
- income per capita (at purchasing power parity)		[-85% ; 0%]	
Other needs indicators		[-27% ; +13%]	1/21
- youth (<15 year) dependency ratio	[0% ; 13%]		
- HIV/Aids prevalence in population (15-49 years)	[0% ; 18%]		
- social deprivation: UNDP human poverty index	[0% ; 27%]		
- malnutrition: severely underweighted under five children	[0% ; 08%]		
- vulnerability	[1% ; 14%]		
Performance criteria		[-29% ; +40%]	
- financial performance	[-20% ; +17%]		
- economic performance	[-14% ; +16%]		
- social performance	[-20% ; +20%]		
Combined impact of the other needs and the performance criteria		[-30% ; +44%]	1/25 (*)

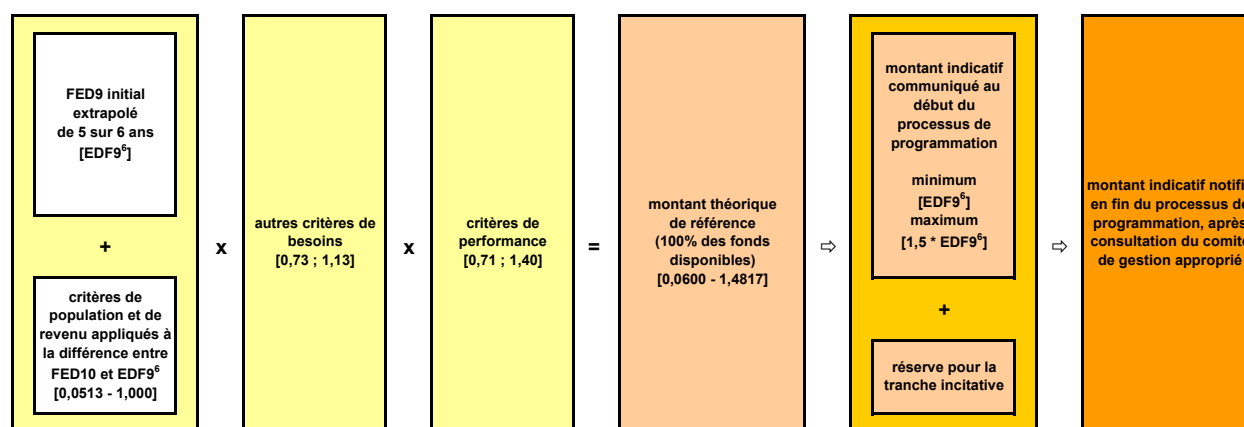
(*) Before taking into account the impact of the minimum and maximum ceiling

¹¹⁰ All correction coefficients have been calibrated in such a way that variance remains within pre-determined limits and that the approach allows for sensitivity analysis of each needs and performance indicator separately and cumulatively.

While the added impact of performance on the aid allocation further increases the theoretical differentiation between countries in terms of aid per capita to 1/25, the search for minimal continuity with the 9th EDF exacerbates this result:

- For efficiency reasons linked to economies of scale, all recipient countries under the 9th EDF received a minimum aid allocation. For some micro-states, in particular in the Pacific region, this approach resulted in a dramatic correction of the theoretical aid allocation and of average annual aid per capita which topped €200 in Niue and €60 in Tuvalu, compared to an ACP average of €2,33. To ensure continuity and predictability of aid, post 9th EDF aid allocations will not be lower in nominal terms than the 9th EDF allocation extrapolated over 6 years.
- The guaranteed minimum also protects some higher middle income countries and weak performers from an excessive downward impact of the updated aid allocation criteria, in order again to ensure a minimal continuity in nominal aid resources.

On the other hand the search for minimal continuity also mitigates the variance in aid allocations by imposing an upper limit to the possible increase in aid allocation. The updated criteria and the changing needs and performance of the recipient countries may indeed lead to very significant increases in theoretical aid allocations, in particular in the larger and poorest but well performing countries. In order to take into account the limited aid absorption elasticity, an upward limit on variation in nominal aid will also be fixed, at least during the first stage of the aid allocation exercise at the start of the programming phase and before the incentive tranche has been determined. As working hypothesis while waiting for the 10th EDF financial protocol to be adopted, this ceiling is provisionally fixed at 1,5 times the 9th EDF extrapolated over 6 years. The methodology adopted can be represented as follows:



While the theoretical reference amount is strongly influenced by the basic population and income per capita factors, the combined impact of the other needs factors and performance indicators is very significant, changing the relative share in aid allocation from -30 to +44¹¹¹. This means that two countries starting from a similar aid per capita level on the basis of the sum of the 9th EDF extrapolated over 6 years and the population and income per capita criteria

¹¹¹ While the impact of the other needs criteria in isolation is situated between -27 and +13% and of the performance criteria between -29 and +40%, the combined effect remains limited to a range between -30 and +44% as a result of neutralising factors, demonstrating that the most needy countries are not necessarily the worst performers.

applied to the additional post 9th EDF funding, could end up with one country receiving more than double in aid per capita terms than the other country¹¹².

As pointed out earlier, an additional incentive tranche will be negotiated during the programming exercise based on a contractual approach fixing results-oriented objectives which can be objectively monitored. This two phase approach will further strengthen the impact of the performance criteria, both quantifiable and qualitative. On the basis of a joint evaluation of performance at mid term and end of term, the initial allocation will be adjusted where required.

4.2 MDG orientation of the aid allocation criteria

As can be seen in following table, most main millennium development goals have been integrated in the aid allocation model¹¹³.

Millennium development goals	Criteria used
G1: Eradicate extreme poverty I-1. proportion of population below 1 USD (1993 PPP) per day I-4. prevalence of underweight children aged under five years	(2) digressive income per capita indicator (3) UNDP human poverty index (HPL ₁) (3), (3a) reinforced component of HPL ₁ index
G2: achieve universal primary education I-6. net enrolment in primary education at 100% by 2015 I-7. primary completion rate I-8. Literacy rate of 15-24 year-olds	(7) progress towards I-6 (7) gross/net enrolment ratio (3) adult illiteracy rate in HPL ₁ indicator
G3: promote gender equality I-9. Ratio of girls to boys in education	(7) gender ratio in primary education
G4: reduce child mortality I-13. Reduce by 2/3 by 2015, the under-five mortality rate	(7) progress towards I-13 (3) probability not to survive beyond 40 years
G5: improve maternal health	
G6: combat HIV/Aids, malaria and other diseases I-18. HIV prevalence among pregnant women aged 15-24 years	(2a) income corrector for HIV prevalence
G7: ensure environmental sustainability I-25. Proportion of land area covered by forest I-30. Proportion of population with sustainable access to an improved water source	(6a) land pressure as ratio of arable land use (3) component of HPL ₁ index (6a) natural resource rent
G8: develop a global partnership for development T-12: open, rules-based, predictable system, commitment to good governance T-13: special needs for the least developed countries	(4) compensation for growth volatility (5) ODA dependency ratio + guaranteed minimum ODA level (EDF9 continuity) (6) import tariffs, investments, business environment (2) digressive income per capita indicator

¹¹² The maximum theoretical range = $(1+0,44)/(1-0,30) = 2,06$.

¹¹³ One exception is the goal relating to maternal health as the statistics in this field are weak and very sensitive to errors (small sample size and sensitivity to reporting of maternal mortality ratios; absence of harmonised definition of skilled health personnel, including traditional midwives).

T-14: special needs of landlocked and small island economies	(3) UNDP human poverty index HPI ₁ (4) LDC dummy (6a) debt integrated in macroeconomic performance (7) social sector expenditures + aid going to LDCs / LICs >90%
T-15: sustainable debt	(1) digressive population indicator (4a) landlocked / small island dummy
T-16: strategies for decent and productive work for youth	(4a) income corrector for geographic isolation + guaranteed minimum ODA level (6a) debt integrated in macroeconomic performance (1a) special weighting for youth

4.3 European consensus

Due attention has been given in the aid allocation model to the areas of specific concern for the EU as reflected in the European consensus:

European consensus	Criteria used
A1: Governance and reforms	Incentive tranche
A2: Trade and regional integration	(6) + RIPs
A3: Infrastructure and transport	(4a) geographic isolation
A4: Water and energy	(3) access to improved water
A5: Social cohesion and employment	(7) public expenditure structure
A6: Human and social development	(3) & (7) illiteracy, health and education targets
A7: Rural development, territorial planning...	(3a) & (4a) food security and geographic isolation
A8: Environment and natural resource management	(6a) natural resource rent and pressure on arable land
A9: Prevention of conflicts and state fragility	Balance between needs and performance criteria

While the 9th EDF heavily penalised fragile states through discretionary reductions in aid allocations as a result of weak performance linked to political instability, the post 9th EDF has a stronger needs bias in the first phase of the allocation process, allowing the post-crisis countries to obtain a larger than average increase in their initial aid allocation. The programming process will confirm if they are recovering and reforming in a way that justifies further increases through an incentive tranche.

In addition the aid allocation criteria also follow the focus on Africa (>90% of our aid) and on the LICs (>90%).

ANNEX 1: Bibliography

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ANNEX 2
Comparison between 9th EDF and post 9th EDF technical allocation criteria, programmable funds,

I. NATIONAL INDICATIVE PROGRAMMES

9 th EDF	Post 9 th EDF – basic scenario	Range
NEEDS	NEEDS	
1) Population: < 1,5 million: linear equation > 1,5 million: natural logarithm	1) Population: size of the needs $P^c = 1$ for $P \leq 1$ $P^c = P^{0,4}/P$ for $P > 1$ with P = population (in million, 2004 data)	0,0516 – 1,00 1,00 0,0516 – 1,00
	1a) correction for demographic dynamics $P^{c'} = P^c * [(1+P_{<15})^{0,5} - 0,095]$ $P^{c'} / P^c$	1,00 – 1,13
2) Poverty: > 760US\$/capita: GNP/capita at PPP < 760US\$/capita: $(GNP^{PPP}/cap) * [1+0,2 * \ln(1/((GNP^{PPP}/cap)/1000))]$ allowing a maximum correction of 40% for Ethiopia, the poorest country in GNP ^{PPP}	2) Poverty: depth of the need $Y^c = 1$ for $Y \leq 825$ (LICs) $Y^c = -(0,4/(3600-825)^{1/3}) * (Y-3600)^{1/3} + 0,6$ for $825 < Y \leq 3255$ (LMICs) $Y^c = -[(Y-2950)^{1/3} / (10066-2950)^{1/3}] + 1,15$ for $3255 < Y \leq 10066$ (HMICs) $Y^c = 0,15$ for $Y > 10066$ (HICs) where Y = GDP at purchasing power parity (GDP ^{PPP}) per capita (2004 data) 825 = WDR2006 upper limit for low income countries (LICs) 3255 = WDR2006 upper limit for low middle income countries (LMICs) 10066 = WDR2006 upper limit for high middle income countries (HMICs)	0,15 – 1,00 1,00 0,80 – 1,00 0,15 – 0,80 0,15
	2a) correction for HIV/Aids prevalence $Y^{c'} = Y^c * (1+H)^{1/2}$, where H = Hiv/Aids prevalence in the 15-49 year group $Y^{c'} / Y^c$	1,00 - 1,18
3) Social development: $1+0,2 * \ln(1/ISD)$ with ISD = indicator of social development = the life expectancy and education level components of the UNDP Human Development Index	3) level of social development $S^{nc} = (1 + HPI_{L1})^{1/2} - 0,0122$ where $HPI_{L1} = \{1/3 * [(P_1)^3 + (P_2)^3 + (P_3)^3]\}^{1/3}$ P_1 = probability at birth not to survive beyond 40 P_2 = adult illiteracy rate $P_3 = 1/2 * (W_a + {}^{-5}U_w)$ = deprivation indicator W_a = % of people without access to improved water source ${}^{-5}U_w$ = % of moderate or severe underweight children under 5 years old 3a) additional correction for food insecurity $Fi = (1 + {}^{-5}U_{sw})^{1/2}$	1,00 – 1,27
		1,00 – 1,08

	³ Usw = % of severe underweight children under 5 years old $S^{nc'} = S^{nc} * F_i$	1,01 – 1,35
+ vulnerability country index - LDCs +20%, HMICs -20%, Barbados -40%, Bahamas -70% of initial NIP allocation - landlocked states +5%, island states +10% of initial NIP - post-conflict countries +5% of initial NIP	4) correction for vulnerability $S^{vc} = (1 + 2 * t_{0,025} * \sigma_c / T^{1/2}) + C^{LDC}$ Where $t_{0,025}$ = “student” value for two-tailed confidence interval of 95% $\sigma_c = \{ [1/(T-1)] * \sum (G_{ti} - G_{ai})^2 \}^{1/3}$ G_{ti} = yearly growth rate of country i over the period t (1979-2004) G_{ai} = average growth rate of country i over the period t C^{LDC} = +0,05% for LDCs, 0 for other countries 4a) additional correction for geographic isolation $S^{vc'} = (S^{vc} + Geo)/2$ where $Geo = (C_{int} + C_{dom})/2 * C^{L/I}$ $C_{int} = 1$ if freight costs < ACP average, otherwise $\{ [1 + (Fr/M^{fob})] - [1 + (\sum Fr / \sum M^{fob})] \}^{1/3}$ = cost of isolation from world markets M^{fob} = merchandise import free on board; Fr = freight (transport in commercial service imports); $\sum Fr / \sum M^{fob}$ = average share of transport costs for all ACP $C_{dom} = \{ [(1 + Pr/P_d)^{1/2}] \}$ = cost of domestic geographic isolation P_d = population density (population per km ²) Pr = population living in rural areas, proxy for scattered population settlement $C^{L/I} = (1 + 0,05)$ for landlocked and $(1 + 0,10)$ for insular countries, 1 for other countries $S^{nc''} = S^{nc'} * S^{vc'}$	1,01 – 1,20 <i>1,01-1,15</i> <i>1,00-1,05</i> 1,01 – 1,14 1,00 – 1,18 <i>1,00 -1,11</i> <i>1,00 -1,15</i> <i>1,00-1,10</i>
PERFORMANCE	PERFORMANCE	
4) aid performance : absorption capacity Benchmark: level of 8 th EDF commitments at 31/12/1999: - 65-100%: NIP allocation +20% - 50-65%: NIP allocation +10% - 30-50%: NIP allocation unchanged - 15-30%: NIP allocation - 10% - 0-15%: NIP allocation – 20%	5) Aid performance: $F^c = (C^r + R^r)/2$ where $C^r = \{ 0,5 * [1 + 2 * (C_{1105}/A^9)] \}^{1/2}$ = adjusted commitment rate, maximum 1,22 C_{1105} = commitments on 30.11.05 on 9 th EDF A envelop A^9 = initial 9 th EDF A envelop where $R^r = \{ (1 + 3,5)^{1/3} / [1 + (R_{ECT-3}/P_{ECT-3})]^{1/3} \}^{0,5}$ = RAL/disbursement ratio R_{ECT-3} = average RAL (« reste à liquider ») on EDF over 2002-‘04 P_{ECT-3} = average payments on EDF over 2002-‘04 5a) aid dependency $F^{c'} = F^c / A_{dT}$ $A_{dT} = (1 + P_{Tt-3}/Y_{t-3})^{0,20}$ = total donor aid dependency ratio over last 3 years P_{Tt-3} = average total donor contributions over 2002-‘04	0,81 – 1,19 <i>[0,81-1,22]</i> <i>[0,81-1,22]</i> 0,80 – 1,17 <i>[1,00-1,10]</i>

Y_{t-3} = average GNI over 2002-'04		
<p>5) Macro-economic performance: b.1. structural adjustment performance: the period that COM funded SAFs were not off track over 1991-'99: - 70-100%: NIP allocation +20% - 40-70%: NIP allocation +10% - 20-40%: NIP allocation unchanged - 10-20%: NIP allocation - 10% - 0-10%: NIP allocation - 20% b.2. existence of a SAP with the IMF - IMF SAP ongoing: NIP allocation +10% - no IMF SAP but one is planned or an IMF SAP is ongoing but risks being stopped: NIP allocation + 5% b.3. Commission assessment of good governance +/- 5%</p>	<p>6) Economic performance: $E^c = (I^{cl} + E^m)/2$</p> <p>6a) Investment climate index $I^{cl} = [B_{sme} + 1/(1+NRP_t)]/2 * [(1+FDI_{t-3}/GCF_{t-3})^{1/3} + (1+GDCF_{t-3}/Y_{t-3})^{2/3}]/2$ $B_{sme} = (2/t_s^{1/3} + 1/t_p^{1/3} + 1/t_c^{1/3})^{1/2} + 0,0389$ = regulatory environment for domestic business, t_s = time required to start a business, t_p = time required to register property, t_c = time required to enforce contracts $1/(1+NRP_t)$ = trade openness measure NRP = nominal rate of protection (nominal tariff weighted for import structure) $(1+FDI_{t-3}/GCF_{t-3})^{1/3}$ FDI = foreign direct investment, t-3 = average over last 3 years (2002-'04) GCF = gross capital formation, t-3 = average over last 3 years (2002-'04) $(1+GDCF_{t-3}/Y_{t-3})^{2/3}$ GDCF = $GCF * [1 - (FDI/GCF)]$ gross domestic capital formation Y = GDP, t-3 average over last 3 years (2002-'04)</p> <p>6b) Macroeconomic performance $E^m = \{ [1 + (\Delta^{t-5} Y^{sust})] * [1 - \Delta^{t-5} D^e * (D^e/Y_t)]^{2/3} * Env \} * (1+MTR)^{1/4}$ $\Delta^{t-5} Y^{sust}$ = environmentally sustainable growth over the last 5 years (1999-2004) : = $[1 + (\Delta^{t-5} Y - I^{NRR})]$ where $\Delta^{t-5} Y$ = average annual per capita growth of GDP^{PPP} over the last 5 years I^{NRR} = index of average annual natural resource rent = $(NRR^t/Y^t)^2$ (measures the level of exploitation of non renewable natural resources) $\Delta^{t-5} D^e$ = average annual evolution in external debt over the last 5 years as % of GDP $[1 - \Delta^{t-5} D^e * (D^e/Y_t)]^{2/3}$ Env = measures environmental pressure on agricultural extension = $1 + (AL - 1) * Agr$ where $AL = \{ AL_{un} / [(AL_{un}) * (1 + \Delta^{t-5} AL_u)] \}^{1/3}$ AL_{un} = unused arable land AL_u = used arable land, change over 5 years (1997-2002) Agr = share of agriculture in GDP MTR = mid term review aid reallocation (envelop A) as a share of initial 9th EDF allocation</p>	<p>0,86 – 1,16</p> <p>0,91 – 1,07 [0,77-1,00] [0,84-1,00] [1,00 – 1,26] [1,00 – 1,19] 0,81 – 1,32 [0,80 – 1,12] -0,05 ; +0,12 0,00 ; +0,16 -0,15 ; +0,33 [0,81 – 1,09] [0,89 - 1,00] [0,93 – 1,29]</p>
<p>6) Political performance: c.1. armed conflict: - country in armed conflict: NIP -10%</p>	<p>6) political performance: = part of policy dialogue during programming</p>	

<p>- country involved in regional peace efforts: NIP +10%</p> <p>c.2. human rights assessment of 3 indicators: level of summary executions and torture; independence of judiciary system; civil liberties (free association...): +5, +2,5, 0, -2,5, -5%</p> <p>c.3. Institutional accountability: assessment public finance management (corruption), & effectiveness public administration: +10, +5, 0, -5, -10%</p>		
<p>7) Social sector performance</p> <p>d.1. if ISD ranking more than 5 places better than GNP^{PPP} ranking, + 5% , if more than 5 places worse, -5%</p> <p>d.2. if ISD level improved with more than 5 basic points over the period 1992-97, +5%, if ISD level deteriorated with more than 5 basic points, -5%</p> <p>d.3. global assessment of social performance by Commission: NIP allocation adjusted +/- 5%</p>	<p>7) Social performance: $S^{pc} = (G^c + E^c + H^c)/3$</p> <p>$G^c = [(G_s - G_m)/G_s]^{1/2} * G_{pe}^c$ with $G_{pe}^c = [(1 + G_{pe}/G_e) * (N_e) * (N_e/N_g)]^{1/3}$ If $(G_s - G_m)/G_s < 0,5$; 0,5</p> <p>$E^c = [1 + (N_{eg}^{2003} - N_e^{1990}) / [1 + 0,5 * (1 - N_e^{1990})]]$ if $(N_e^{2003}/N_e^{1990}) < 0,9$; $E^c = 0,72$; if $N_e^{2003} = 1$, $E^c = 1,12$</p> <p>$H^c = [0,8667 - 0,5 * (-2/3) - ({}_{.5}MR^{2003} - {}_{.5}MR^{1990}) / {}_{.5}MR^{1990}] / [0,8667 - 0,5 * (-2/3)]$ if ${}_{.5}MR^{2003} > {}_{.5}MR^{1990}$, $H^c = 1$</p> <p>G^c = corrector for share of social sectors in public expenditure compared to military expenses G_s = public expenditures in social sectors (health and education) G_m = security related public expenditures (military, security, presidency) G_e = public expenditure on education; G_{pm} = public expenditure on primary education G_{pe}^c = share of public expenditure on primary education in total education budget, corrected for efficiency indicators N_{eg} = net enrolment in primary education corrected for gender inequality = $N_e * (G_p/B_p)$ where (G_p/B_p) = ratio of girls/boys in primary education N_g = gross enrolment in primary education E^c = MDG corrector for progress towards universal primary education by 2015 H^c = MDG corrector for progress in reducing under-five mortality rate by 2/3 over 1990-2015 ${}_{.5}MR$ = under five mortality rate</p>	<p>0,80 – 1,20 [0,77-1,24] [0,72-1,12] [0,90-1,29]</p>
	<p>CONSOLIDATED RESULTS</p> <p>P^c</p> <p>$P^c * Y^c$</p> <p>$C^{Needs} = P^c * Y^c * S^{nc}$</p> <p>$NIP^{Needs} / NIP^{Pop*Income} -1$ (previous, corrected for country weighting)</p> <p>Performance corrector</p> <p>$C^{Perf} = F^c * E^c * S^{pc}$</p>	<p>0,0516 – 1,0000</p> <p>0,0513 – 1,0000</p> <p>0,0709 – 1,4644</p> <p>[-27% ; +13%]</p> <p>0,71 – 1,40</p>

	$C^{Needs+Perf} = C^{Needs} * C^{Perf}$ $NIP^{Needs+Perf} / NIP^{Needs} - 1$ $NIP^{Needs+Perf} / NIP^{Pop*Income} - 1$ $NIP^{Needs+Perf} = [(C^{Needs+Perf}_i * P_i) / \sum(C^{Needs+Perf}_i * P_i)] * A$ <p>A = initial programmable NIP amount post 9th EDF</p>	<p>0,0600 – 1,4817</p> <p>[-29% ; +40%]</p> <p>[-30% ; +44%]</p>
<p>Final corrections:</p> <ul style="list-style-type: none"> - ensure that NIP allocation of well performing LDCs is not below 8th EDF allocation (Cabo Verde + Kiribati) - cap on increase of NIP allocation for HMICs (T&T) - overall cap on increase of NIP allocation to ensure absorption capacity (PNG + Gambia) 	<p>Minimum = 9th EDF extrapolated over 6 years</p> <p>Maximum initial allocation = 1,5 * 9th EDF extrapolated over 6 years</p>	
<p>Non-programmable funds (B-envelope):</p> <p>1. economic vulnerability index EVI (OECD/DAC) : equally weighted (i) population, (ii) share of manufacturing and services in GDP, (iii) export concentration ratio, (iv) agricultural production instability, (v) export instability:</p> <ul style="list-style-type: none"> - > 55, +20% of A-envelop - 45-55, +15% of A envelop - 40-45, +10% of A envelop - <40, +5% of A envelop <p>2. predictability index: ratio of (Stabex+Sysmin)/(NIP+SAF) over 1991-1999</p> <ul style="list-style-type: none"> - > 5,0, + 300% of A envelop - 1,6-5,0, +100% of A envelop - 0,5-1,6, +30% of A envelop - 0,25-0,5, +15% of A-envelop - 0,1-0,25, +5% of A envelop <p>3. HIPCs: +10% of A envelop</p> <p>4. Natural disaster and conflicts vulnerability: global vulnerability index of the OFDA/CRED International Disaster Database (UCL)</p> <ul style="list-style-type: none"> - ranking >5, +5% of A envelop - ranking 1-5, +2,5% of A envelop 	<p>Non-programmable funds (B-envelope):</p> <ul style="list-style-type: none"> ▪ Rolling programming, initial allocation covering 2 years estimated needs ▪ Country specific allocation based on minimum reserve of 1,5% of A-envelope + track record under 9th EDF ▪ During the programming process the decision can be taken to transfer an amount from A to B envelopes for emergencies in countries in crisis or post-crisis situation without signed CSP; ▪ A single consolidated replenishment decision after the annual reviews ▪ Ad hoc decisions 	

II. REGIONAL INDICATIVE PROGRAMMES

9 th EDF	Post 9 th EDF – basic scenario	Range
10% of constituent NIPs (A+B envelopes)	<p>13% of constituent NIP (A envelopes) corrected for</p> <ol style="list-style-type: none"> 1. estimated use of B-envelopes (based on theoretical record under 9th EDF to date) 2. intra-regional exports as share of total regional exports (2004) 3. island regions (+10%) 4. Mid term review reallocations, as proxy for 9th EDF performance <p> $RIP = \{\sum NIP^R * 0,015 + (\sum B^{RU} / \sum B^R) * 3 * [\sum B^{10} - (\sum NIP^R * 0,015)] * 0,13 * (1+E^{IR}) * (1+R^{Is}) * (1+MTR/RIP)$ </p> <p>With $\sum NIP^R$ = sum of the constituent NIPs in region R</p> <p>$(\sum B^{RU} / \sum B^R)$ = share of regional B envelopes under 9th EDF which have been used</p> <p>$[\sum B^{10} - (\sum NIP^R * 0,015)]$ = share of the 10th EDF B envelopes allocated on the basis of historical data</p> <p>E^{IR} = intra-regional exports as share of total regional exports</p> <p>R^{Is} = dummy (10%) for island regions</p>	<p>0,77 – 1,73</p> <p><i>[0,94 – 1,35]</i></p> <p><i>[1,00 – 1,10]</i></p> <p><i>[1,00 – 1,10]</i></p> <p><i>[0,75 – 1,29]</i></p>