

# International Development and the next EU Budget

June 2020

An analysis of the European Commission's proposals on EFSD and EFSD+ in the revised NDICI and Next Generation EU

## BACKGROUND

The outbreak of Covid-19 has triggered a health, social and economic crisis that exacts its heaviest toll on the marginalised and most vulnerable, further exacerbating existing inequalities. Women are particularly exposed to the virus as they make up the majority of workers in care, social, and frontline health services, and they are also caring for the sick in families. Women are also hit harder economically as many work in the informal economy and small enterprises, which are among the worst impacted by the pandemic.

The pandemic exposes the depth of inequalities within and between countries and the consequences of decades of austerity policies that have undermined public health systems and stifled progress on universal social protection. The pandemic also exposes systemic weaknesses of the prevailing development model, resulting in climate change, environmental degradation and biodiversity loss. A heavy reliance on private finance to deliver public services and public goods has incentivised - and may have even reinforced - these problematic trends.

The EU has responded to these multiple crises by issuing the "Next Generation EU" package, as well as a revised budget for external action as part of the MFF proposal. Below we share key concerns and policy recommendations for the ongoing negotiations.

### 1. Amounts involved

The "Next Generation EU" package comes with an additional €10.5 bln for the External Action Guarantee (EAG) to be spent by 2024 to guarantee loans for the private and the public sector. While it is welcome that new resources will be front loaded to address urgent needs, the fact that this is channelled through the EAG creates a critical challenge.

The stated objective is to guarantee up to €130 bln over the 2021-2027 period, which represents more than the double of the initial Neighbourhood, Development and International Cooperation Instrument (NDICI) target of €60 bln. Given the experience of the current European Fund for Sustainable Development (EFSD) instrument so far, this is an unrealistic target, especially as the €10.5 bln from the Next Generation EU is to be spent by 2024. We see a risk that the European Commission might lower its selection criteria and quality checks to make sure that the target is met by this tight deadline. In addition, we do not consider it reasonable to earmark the whole additional amount from Next Generation EU to the EAG, given that this instrument is yet to yield tangible results, and has not yet proven to deliver on human rights, the Sustainable Development Goals (SDGs) and climate and environmental protection. At this stage, we do not consider that there is any sound justification for scaling up the EFSD guarantee model stemming from the EC Implementation Report<sup>1</sup> and the recent evaluation carried out by external consultants.<sup>2</sup>

Promises for future financial leverage do not constitute evidence of positive development impacts.

**In its report on the NDICI, the European Parliament recommended that a maximum of €10 bln be provided from the NDICI's budget for guarantees. We therefore suggest abiding by this cap and awaiting the 2024 mid-term review to determine whether additional funding should be earmarked to the instrument.**

### 2. Priority Sectors for intervention

The current crisis shows the critical need for strong public health, education, food and water and sanitation systems that are grounded in human rights. This should include adequate financial and human resources that allow for responses to sanitary urgencies and other looming crises, such as the climate crisis. Privatisation of public services and public-private partnerships (PPPs) erode service capacity, undermine equity, and are often more expensive for the public purse. **The focus of EU development interventions should be to strengthen public systems, particularly health, education, food and social protection. EU ODA should not be used to promote the involvement of private for-profit companies in public services, through privatisation schemes and PPPs.**

Priority must be given to activities that are both human rights and tax compliant, as well as green activities that are consistent with the Paris Agreement, environmental

objectives and the “do no harm” oath. This would include the exclusion of specific companies and activities, for instance, companies that use tax havens for tax avoidance and environmentally harmful activities such as fossil fuel related investments, and the use of screening tools such as environmental and climate impact assessments. It is important to set a target of at least 50% for ESFD+ to support climate and environmentally relevant investments and 85% for gender mainstreaming.

In the midst of the current crisis, we need to support private sector actors in partner countries. However, the EFSD+, when it is used to subsidise private companies, should primarily focus on supporting local economic actors and inclusive business models, such as cooperatives and social enterprises, micro, small and medium-sized enterprises and promote decent jobs creation for women and young people in particular. It should also be used in support of the informal sector, in order to develop local markets, foster domestic competitiveness and create a private sector that is aligned to and delivers on sustainable development objectives and the Paris Agreement.

In addition, the EFSD+ has to be effective in protecting the tax base of partner countries. Many big corporations command huge financial resources and use tax avoidance schemes to shift their profits offshore, while their investments in partner countries often take the form of mergers and acquisitions or other rent-seeking activities, creating no new economic and employment opportunities in those countries.<sup>3</sup> Steps must be taken to ensure that financial standards and/or environmental protections and policies are not lowered or delayed in order to incentivise investments. Doing so risks undermining the environmental integrity of existing efforts to green private finance flows.

We wish to see thriving local economies in partner countries, and while subsidies to companies have a role to play in times of crisis, it is also important to have a local environment that is conducive to a fair and inclusive economy. This means a sound legal framework; clear and fair fiscal standards; effectively implemented labour standards; independent trade unions; and workers’ organisations able to engage in social dialogue. It also means well-functioning democratic institutions and administrations and good governance, including of natural resources. Subsidising private companies with development assistance is not a long-term solution.

Last but not least, civil society organisations, both local, regional and international, are expected to be heavily impacted by the crisis triggered by the pandemic, with lower capacity for individual giving combined with shrinking public resources to support the third sector. In many countries around the world, the pandemic has also been used as a pretext to crack down on civil society, limit civil liberties, and silence opposition voices. It is therefore fundamental for the EU to make sure the support aimed at rebuilding post-Covid-19 societies and economies does not only assist the public sector and businesses, but also supports civil society organisations at all levels.

### 3. Financing Modalities matter

The additional €10.5 bln substantially increases the proportion of the NDICI to be delivered through the EAG for the public and private sector, thereby reducing the weight of other modalities (grants and budget support) in the overall budget for external action. This is a massive shift in EU aid modalities, in favour of a mechanism that, as stressed earlier, has not proven yet to deliver on international development cooperation objectives or to bring added value compared to the existing mix of modalities.

Over the past decade, loans as a share of total ODA disbursements to developing countries have been increasing, which is even more evident in the case of Least Developed Countries (LDCs). As the need for additional fiscal space to tackle Covid-19 and its economic fall-out is increasing, the capacity of developing countries – and certainly those countries most in need – to absorb additional lending is decreasing. In 2019, 64 countries spent more money on debt service payments than on health services.<sup>4</sup> In this context, **there is a strong need for donors to prioritise grant-based financing as the default option, especially to LDCs, while also re-assessing reporting directives to remove incentives that favour loans over grants. When loans are provided they should be highly concessional and with maturities and grace periods of a sufficient length to avoid increasing debt vulnerabilities.**

Moreover, EU development resources should give preference to budget support to recipient countries without political and economic conditionality, in line with development effectiveness principles. This allows countries to use funds according to needs, including to hire extra staff, buy tests and protection supplies, but also to mitigate the economic and social impact of Covid-19. The European Union has significant and positive experience in providing budget support and reinforcing public health systems in partner countries. It makes more sense to increase investment in these areas that are of critical and immediate importance than channelling new resources in a single untested instrument that may or may not prove successful in the future.

In the current context, the financial and development additionality of blended finance – a combination of official development assistance with other public or private resources – is more critical than ever, which poses a risk when favouring the EFSD+ as a preferred financing modality. Recent reports clearly show that blended finance is surrounded by unrealistic expectations that do not match the practice on the ground, which is biased towards middle-income countries, and finance and infrastructure.<sup>5</sup> A strong focus on blended finance risks skewing public concessional financing away from those countries most in need and from social sectors such as education and health.<sup>6</sup> Furthermore, a recent report commissioned by the European Parliament on EU blended finance raises specific concerns about its use and plans to scale up in the next MFF. It argues that “while blending is attracting growing support, this is not on the basis of a robust empirical evidence base” and recommends “a radical rethink of the

blending assessment methods and the overall agenda both for the EU and other developmental agencies”<sup>7</sup>

#### 4. Transparency, accountability and safeguards

All operations under the EFSD+ should abide by strict human rights and environmental criteria, and provide for effective and transparent monitoring systems as well as a grievance mechanism accessible to all potentially affected. The responsibility to ensure that all operations benefitting from guarantees, loans, grants or technical assistance abide by the higher standards must lie with the European Commission and it should not be delegated to other intermediaries, such as Development Finance Institutions.

The European Investment Bank (EIB) is likely to play a pivotal role in the implementation of the EFSD+. As for

other development banks, a clear additionality framework should be in place so that the EIB can, in a transparent manner, prove the financial additionality of its operations. As the financial arm of the EU, the EIB should prioritise development additionality and enhance its development-orientation. In particular, the bank should reinforce its assessment of the social and environmental impacts of its operations, for instance through dedicated human rights due diligence at project level and appropriate monitoring and remedy mechanisms.

When it comes to EIB intermediated loans, the bank should ensure that they are subject to the same transparency requirements as other types of loans. The EIB needs to ensure the human resources and methodologies are in place. As part of the review of its Environment and Social standards in <sup>2020</sup>, a new standard on financial intermediaries should set this approach in stone.

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## ENDNOTES

<sup>1</sup> Report from the Commission to the European Parliament and the Council on the implementation of the European Fund for Sustainable Development. 2 June 2020. <https://ec.europa.eu/transparency/regdoc/rep/1/2020/EN/COM-2020-224-F1-EN-MAIN-PART-1.PDF>

<sup>2</sup> BKP Development Research & Consulting GmbH. "Implementation Report of the EFSD and the EFSD Guarantee Fund. Final Report". Report requested by the European Commission. 14 January 2020. [https://ec.europa.eu/commission/sites/beta-political/files/efsd-implem\\_report-external\\_support\\_study-final.pdf](https://ec.europa.eu/commission/sites/beta-political/files/efsd-implem_report-external_support_study-final.pdf)

<sup>3</sup> Kozul-Wright, R. and Blankenburg, S. "The rentiers are here". UNCTAD. 26 September 2017. <https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1564>

<sup>4</sup> Jubilee Debt Campaign. "Sixty-four countries spend more on debt payments than health". 12 April 2020. <https://jubileedebt.org.uk/press-release/sixty-four-countries-spend-more-on-debt-payments-than-health>

<sup>5</sup> Attridge and Engen. "Blended finance in the poorest countries. The need for a better approach". ODI. April 2019. <https://www.odi.org/sites/odi.org.uk/files/resource-documents/12666.pdf>

<sup>6</sup> Attridge, Gouett and Meeks. "Mobilising Private Development Finance: Implications for Overall Aid Allocations". EBA. February 2020: <https://eba.se/en/rappporter/mobilising-private-development-finance-implications-for-overall-aid-allocations/11579/>

<sup>7</sup> Bayliss et al. "The use of development funds for de-risking private investment: how effective is it in delivering development results?" Study requested by the DEVE Committee. European Parliament. May 2020. [https://www.europarl.europa.eu/RegData/etudes/STUD/2020/603486/EXPO\\_STU\(2020\)603486\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2020/603486/EXPO_STU(2020)603486_EN.pdf)

### List of undersigning organisations

- ActionAid EU
- Aidsfonds
- Act Alliance EU
- Alliance 2015
- Brot für die Welt
- Care International
- Cooperatives Europe
- Counter Balance
- Eurodad
- Global Health Advocates
- Oxfam
- Südwind
- Terra Nuova
- Wetlands International EU



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