

EXPERIENCES WITH TRADITIONAL COMPENSATORY FINANCE SCHEMES AND LESSONS FROM FLEX*

1. INTRODUCTION

Developing countries are still highly vulnerable to changes in the economic environment due to exogenous shocks, such as natural disasters (including droughts and floods), conflicts/crisis in neighbouring countries or disturbances in the international trading system, such as volatility of commodity prices or rises in food and oil prices. This high vulnerability of developing countries to shocks is due to several causes, some of which are related to structural factors that characterise their economy. For instance, resilience to shocks is low when an economy depends heavily on the production of just a few commodities, the prices of which often show high short-term variability and/or a long-run declining trend. How a country reacts to shock is also linked to the degree of exposure to the shock itself: the greater the exposure the higher the impact of the shock¹. Other determinants of a country's vulnerability to shocks are the development of financial markets and the functioning and quality of institutions.

* This paper has been prepared with financial assistance from the European Commission and is part of the "Feasibility Study on Compensatory Financing Scheme for Exogenous Shocks" (Contract No. 2008/156263). The views expressed herein are those of the author and therefore, in no way, reflect the official opinion of the Commission. Financial support received by the "European Union Policies, Economic and Trade Integration Processes and WTO Negotiations" research project funded by the Italian Ministry of Education, University and Research (Scientific Research Programs of National Relevance 2007) is also gratefully acknowledged. The author is grateful to Thierry Apoteker, Sylvain Barthelemy, Signe Ohakas, Philippe Van Damme and an anonymous referee for the excellent comments and suggestions on an earlier version of the paper. The usual disclaimer applies.

¹ Exposure to shocks may be expressed, for instance, in terms of trade-openness or in terms of production in climate-dependent sectors, such as agriculture and tourism.

Some attempts to use a single index that combines different aspects of countries' vulnerability show that, over the period 1996-2000, low-income countries registered the highest values on the vulnerability index and that there was a strong negative correlation between vulnerability to exogenous shocks and the level of countries' economic development (Atkins *et al.*, 2000; Crowards, 1999; United Nations, 2006).

As vulnerability to shocks is an influential factor for the growth of developing countries [see, among many others, Guillaumont (2005) and Combes and Guillaumont (2002)], many efforts have been made to address the issues faced by countries affected by exogenous shocks. Experience at the individual country level shows that developing economies have a limited capacity to cope with exogenous shocks, even when they are temporary. In such a case, timely finance would compensate for losses caused by a shock and would help countries to limit the negative impact on growth.

The main constraints faced by governments of developing countries in dealing with the effects of exogenous shocks regard (a) the scarcity and the accessibility of finance to be used as compensation for drops in income or as investments to remove the cause of vulnerability and/or (b) the opportunity costs of holding back reserves and fiscal resources in order to create a self-insurance fund against shocks (Griffith-Jones and Ocampo, 2008; Cortez *et al.*, 2008; United Nations, 2006)².

On a global level, the international community has been asked to design policies aimed at limiting the negative impacts of exogenous shocks. This paper reviews part of the literature relating to the compensatory financing systems which have been implemented to help developing countries suffering from shortfalls in export earnings. In doing this, it only covers one type of exogenous shock, i.e. the short-run variability of export earnings, and only one type of policy dealing with these shocks, i.e. financial assistance to countries whose export proceeds have suffered as a result of an unforeseen decline in commodity prices and/or in quantity traded.

Two major schemes were implemented in the past specifically in order to stabilise the export earnings of LDCs: the Compensatory Financing Facility (CFF) of the International Monetary Fund (IMF)

² These opportunity costs should also be compared with the opportunity cost of ODA mobilised in compensatory facilities versus mitigating actions.

and the STABEX programme laid down in the Lomé Convention. These two schemes operate on an *ex-post* basis and, in this sense, are comparable with the 'FLEX' facility, which is currently used by the EU to provide financial support to ACPs affected by export side shocks.

The choice to pay attention to 'traditional' mechanisms is a consequence of the attempt to learn from the lessons drawn from the way they function. These lessons help the understanding whether these facilities may still be useful for developing countries.

At least in the very short period, an effective step would appear to be the modification of FLEX and similar schemes (e.g., the IMF's CFF), in order to make them more countercyclical. This holds true at a time when the tendency, driven mainly by the World Bank, is towards market-friendly alternatives when dealing with issues relating to the instability of world markets³.

The paper is organised as follows. Sections 2 and 3 describe the working of IMF's CFF and EU's STABEX, respectively. Sections 4 and 5 present an analysis of FLEX support from 2000 to 2007. Section 6 concludes.

2. THE INTERNATIONAL MONETARY FUND'S COMPENSATORY FINANCING FACILITY

The IMF provides financial assistance to its members affected by exogenous shocks through a variety of facilities. Among these facilities, a specific role is played by the Compensatory Financing Facility (CFF), which was set up in 1963, the Stand-by-Arrangements (SBAs), established in 1952, and by two more recent programmes, the Poverty Reduction and Growth Facility (PRGF) and the Exogenous Shocks Facility (ESF) introduced in 1999 and in 2005 respectively. Although all these IMF instruments were set up to assist countries experiencing BoP problems, they differ in several aspects. One example of this is that they pursue different objectives: the CFF explicitly makes the stabilisation of export earnings a central aim, while, for the other instruments, it is an implicit by-product.

In what follows, the working of CFF, and its use by IMF

³ The recent main policy options for export earnings instability have also been reviewed and discussed in Griffith-Jones and Ocampo (2008), Hewitt (2007), Parimal (2006) and Tabova (2005).

members, will be presented and discussed by comparing it with the other IMF lending alternatives. This might help understand the role that CFF and similar schemes may play nowadays as effective policies addressed at enhancing the economic growth of developing countries.

2.1 Aims, Eligibility Requirements and Rules of Operation for the IMF's CFF

The CFF is intended to ensure timely external financing for members experiencing BoP difficulties resulting from a temporary decline in export earnings or a temporary increase in cereal import costs⁴. The basic idea of the facility is that, when a temporary shock to export revenues occurs, the compensating payment allows beneficiaries to maintain aggregate demand at pre-shock level and, thus, to avoid the likely recessionary impact of a sudden drop in exports, presuming the BoP experiences no other problems (on this point, see also Griffith-Jones and Ocampo, 2008, page 2).

In addition to experiencing a BoP problem due to an export earning shortfall or excess cereal import costs, the eligibility requirements include (a) the shortfall in export earnings or the excess cereal import costs have to be temporary, that is they have to be short term in character; (b) the shortfall in export earnings or the excess cereal import costs must be largely attributable to factors beyond the control of the beneficiary country and (c) if the IMF member has BoP difficulties above and beyond the effect of the shock, it must have a new arrangement in place at the time of the request for a CFF purchase. In other words,

“where the BoP is not deemed satisfactory, requests for CFF can only be met in conjunction with an upper credit tranche-type arrangement” (IMF, 2004a, Box 1).

The last qualifying criterion⁵ introduces conditionality in the sense that depends on the terms of the arrangement. This implies

⁴ From November 1990 to December 1991, the CFF temporarily provided assistance to oil-dependent countries when oil prices rose as a result of the Gulf War (IMF, 2003).

⁵ This qualifying criterion was introduced in 2000 in order to “*reduce the need for difficult judgments required in the previous system and reflects the need for some adjustment where balance of payment problems extend beyond the export shortfall or cereal import excess*” (IMF, 2004a, page 7).

that only the stand-alone purchases are not subject to conditionality, in the sense that requests for stand-alone purchases under CFF are met only if the BoP position is satisfactory, apart from the export earnings shock (or the excess in cereal import costs).

The amount that an IMF member can draw is limited by the degree of the estimated drop in exports, subject to a quota limit. In other words, compensation may be asked for when export proceeds in the application year are below their five-year geometric year centred on the shortfall year, and with projections used for the two post-shortfall years. Therefore this method for calculating the shortfall requires that the export figures in the two years successive to the shock (N+1, N+2) are estimated by the IMF in conjunction with the participating country⁶.

The deviation of actual export earnings from the reference value is fully compensated if it does not reach the member's quota limitation. The current operating rules of the CFF limit to 45 percent of a member's quota the amount that can be drawn from the facility to compensate for an export shortfall or an increase in cereal import costs. This percentage is 55 percent when the shock affects both the exports and the imports of the claiming country⁷.

Another important CFF operating rule concerns the fact that transfers are loans and must be repaid within five years; repurchases are to be made in equal quarterly instalments between the third and the fifth years. Finally, being non-concessional loans, interest has to be paid by all countries, based on the base rate charged under the General Resources Account of the fund.

⁶ In the past, the medium-term trend of export earnings was determined by using different formulas. For instance, in 1963, the IMF used a mixed method combining (a) the weighted average of the last two pre-shock year values (with weight of 0.25) and of the value of the application year (with a weight of 0.5) and (b) forecasts for the first two post-shock years. The current method for calculating the trend and the shortfall was implemented in 1979 after observing that export earnings increase geometrically (i.e., by a constant rate) and not arithmetically (i.e., by a constant amount) (Lim, 1991, page 59). It is also considered appropriate because use of the medium-trend value of export earnings permits consideration of the fact that a *“deceleration of export growth could lead to a fall of output below its long-term growth trend, and a below-trend output is precisely what one should try to avoid when an economy is hit by a shock”* (Griffith-Jones and Ocampo, 2008, page 10).

⁷ The quota limit has been revised many times since 1963. In the beginning it was 25 percent of quota, in 1996 it was raised to 50 percent and it reached 100 percent of a member's IMF quota in 1979 (Lim, 1991, page 60).

2.2 The CFF and other IMF Lending Facilities: Who can Apply for CFF Support?

All IMF members are eligible for CFF support, provided that the export side shock meets the above-described qualifying criteria. Besides the CFF, the Fund has implemented alternative instruments to help its members affected by exogenous shocks.

For instance, non-concessional loans are provided, mainly through Stand-By Arrangements (SBA), and occasionally through the Extended Fund Facility (EFF) or the Supplemental Reserve Facility (SRF)⁸. Since 1952, IMF members have been able to borrow from SBAs, which provide members with assistance so that they can draw on up to a specified amount, usually over 12-18 months, to deal with a short-term BoP problem. The term 'stand-by' means that, subject to conditionality, a member has a right to draw the money made available if needed.

In 1999 the IMF introduced the PRGF which is a concessional lending window intended to give a more central role to pro-poor growth considerations in the design of IMF-supported programmes in LICs. Eligibility for PRGF support is based on IMF assessment of a country's *pro capita* income, drawing on the cut-off point for eligibility to World Bank concessional lending (currently 2007 *pro capita* GNI of less than US\$1095)⁹.

⁸ In 1974 the IMF introduced the EFF, which is intended to help IMF members tackle structural economic problems that are causing serious weaknesses in its balance of payments. Since 1997, the SRF has provided additional short-term financing for members experiencing exceptional balance of payments difficulties because of a sudden, disruptive loss of market confidence reflected in capital outflows (www.imf.org).

⁹ As of August 2008, the PRGF-eligible countries are: Afghanistan, Albania, Angola, Armenia, Azerbaijan, Bangladesh, Benin, Bhutan, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde(a), Central African Republic, Chad, Comoros, Congo, Democratic Republic of Samoa(a), Republic of Congo, Ivory Coast, Djibouti, Dominica(a), Eritrea, Ethiopia, Gambia, Georgia, Ghana, Grenada(a), Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, India, Kenya, Kiribati, Kyrgyz Republic, Laos, P.D.R., Lesotho, Liberia, Madagascar, Malawi, Maldives¹, Mali, Mauritania, Moldova, Mongolia, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Papua New Guinea, Rwanda, Sao Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, St. Lucia(a), St. Vincent and the Grenadines(a), Sudan, Tajikistan, Tanzania, Timor Leste, Togo, Tonga(a), Uganda, Uzbekistan, Vanuatu(a), Vietnam, Yemen, Republic of Zambia, Zimbabwe(b). (a) In 2007 an exception to the GNI *pro capita* operational cut

Unlike under the CFF, loans under the PRGF carry an annual concessional interest rate of 0.5 percent, with repayments made semi-annually, beginning 5½ years and ending 10 years after the disbursement. Another important difference with respect to the CFF is that PRGF-eligible countries may normally borrow up to a maximum of 140 percent of their IMF quota under a three-year arrangement (the upper threshold of the disbursement may be increased to 185 percent of quota in exceptional circumstances). The amount will depend on the country's BoP needs, the strength of its adjustment programme, and its previous and outstanding use of IMF credit. Finally, 'low-access' PRGF programmes with a standard level of 10 percent of quota may be used for members with little or no immediate BoP problems¹⁰.

The above short description of IMF facilities allows the depiction of what the financial channels are through which a member may apply for assistance when it has a BoP problem. It is quite clear that PRGF-eligible countries with a PRGF programme in place access

off for IDA eligibility (a 2007 GNI *pro capita* of less than US\$1,095) was made for some small island economies; these countries continue to be eligible for PRGF and IDA assistance, notwithstanding their *pro capita* income levels. (b) Since 24-09-2001, Zimbabwe has been ineligible due to overdue financial obligations to the PRGF Trust.

¹⁰ Other significant differences between the CFF and the PRGF lie in the latter's three distinctive features. We firstly refer to the principle of broad public participation and greater country ownership which are central to the PRGF. With regard to this, discussions on the policies underlying PRGF-supported programs are more open, since they are based on the nationally owned Poverty Reduction Strategy Papers. With increased national ownership, PRGF conditionality is expected to be more parsimonious, focused on the Fund's core areas of expertise, and limited to measures that have a direct, critical impact on the program's macroeconomic objectives. Secondly, PRGF programmes are intended to be more closely linked to each country's poverty reduction and growth priorities. Key policy measures aimed at poverty reduction and growth are identified and given priority during the PRSP process, and, if feasible, their budgetary costs are assessed. Thirdly, PRGF programmes focus on strengthening governance, in order to assist countries' efforts to plan targeted, well-prioritised spending. Measures to improve public resource management, transparency, and accountability are of particular importance. While an exhaustive evaluation of PRGF-supported programmes is not available (the effects of IMF support on poverty reduction and growth may be evaluated only in the medium-long run), assessments of how PRGF-programmes have worked since 1999, in terms of the guiding principals (conditionality, ownership and governance) can be found in IMF (2004a, 2005, 2007).

funds through their arrangements with the IMF rather through the less concessional CFF (see also dePlaa and Tabova, 2005, on this point). Furthermore, there is the case of IMF members which are eligible for PRGF but do not have a PRGF in place. These countries are entitled to the ESF instrument which offers similar conditions to the PRGF and, thus, is more concessional than the CFF.

In practice, there is an overlapping of lending facilities (PRGF/ESF, CFF, SBA) for LICs experiencing a BoP problem. It is inconvenient for these members to access CFF or SBA because they can borrow from PRGF at concessional interest rates, while only those countries not eligible for PRGF (those with a 2007 GNI *pro capita* of more than \$1,095) turn to the CFF or to SBAs.

2.3 The Use of IMF's CFF

The most recent source of complete information about the CFF is the last review of 2004 (IMF, 2004a). The reported data indicate that the facility was used 344 times over the period 1963-1999. Its use was recurrent in the 1970s and in the early 1980s when the CFF absorbed a large proportion of the total credit that the IMF extended to developing countries [the peak was reached over the period 1976-1980 when use of the CFF accounted for 45% of total IMF lending (Goreux, 1980)]. While Griffith-Jones and Ocampo *et al.* (2008, Table 2) report data indicating that the average incidence of CFF transfers was 10.69% of total IMF credit from 1990 to 2006, it is worth noticing that the facility has not been used since 2000, even though many IMF members experienced substantial drops in exports in the tourism sector due to the attacks of 11th September, 2001 and, in 2002, southern African countries suffered a supply shock in cereal sectors because of drought (IMF, 2004a, page 6). In such circumstances, the countries affected by these exogenous shocks prefer not to use the IMF's CFF because of high conditionality and of the possibility of using other financial support which is more attractive than the non-concessional CFF (IMF, 2004a, page 6; Griffith-Jones and Ocampo, 2008, page 11). The availability of alternative sources of financing, which are thought to be superior to CFF, is the main reason given by IMF staff to explain the limited use of CFF (these views are widely discussed in IMF, 2004a and 2004b).

The following data provide useful details about which kind of facility is used by IMF members. As of 19th March, 2009, 23 PRGF eligible countries have a PRGF arrangement in place. The

total amount agreed to all these PRGF-programmes is 1,200 million SDRs. Among the current PRGF supported countries, 19 belong to the ACP group. Again, 3 PRGF-eligible countries without an active PRGF (Kyrgyz Republic, Malawi and Senegal) have an ESF-type arrangement (the total amount of loans agreed is 167 million SDRs). At the same date, no country has a CFF-type loan, while 14 countries have an active stand-by-arrangement (SBA) with the IMF and borrowers receive a very large amount of finance (33,369 million SDRs) through this lending instrument¹¹. Looking at the recent past, it emerges that SBAs have been the facility which IMF members have used the most over the last decade too. For instance, as of 29th December, 2000, 16 countries had an SBA in place (the amount agreed was 28,007 million SDRs), while there were 9 active extended arrangements (9,113 million SDR) and there were 34 PRGF in place (3,135 million SDRs)¹².

The above distribution of IMF lending by facility reflects, other thing being equal, the incentive to borrow from one instrument rather than from others. What clearly emerges is that the PRGF has introduced an asymmetry between LICs and middle-income-countries, in the sense that nowadays the former mainly turn to PRGF, or to its augmented access to accommodate temporary shocks, as it is more concessional than others. Today PRGF-eligible countries without a PRGF, essentially LICs which are starting to feel the effect of the current financial crisis, are beginning to use the ESF¹³. On the other hand, middle-income-countries mainly use SBAs, whose assistance allows borrowers to deal with shocks for which the CFF is envisaged (as said above access SBAs has been

¹¹ Data available at <http://www.imf.org/external/np/tre/activity/2009/021909.htm>.

¹² Data available at <http://www.imf.org/external/np/tre/activity/2000/122900.htm>.

¹³ The ESF is a short-term concessional window to help LICs cope with external economic events. It was introduced in 2005 and revised in September 2008 (IMF, 2006 and 2008a). The reduced conditionality burden established in the 2008 revision seems to be enough to convince poor countries to sign up to ESF for the first time. In late 2008 Malawi agreed a 77 million dollar ESF loan, Senegal agreed a 75 million dollar loan, and the Kyrgyz Republic one of 100 million dollar. At the same time, the Comoros islands arranged a loan for 3 million dollar. In January 2009 Ethiopia borrowed 50 million dollar. Loans to Ethiopia and Comoros were for low amounts and will be disbursed under the so-called 'rapid-access component' of the ESF, meaning little conditionality (data are drawn from www.info.org).

massive over the period 2000-2009). In brief, data suggest that the Fund's primary form of support is now through augmentations of the PRGF facility, and SBAs for countries without a PRGF in place.

2.4 Non-use of the CFF and the IMF Decision to Maintain the Facility

The fact that the CFF has not been used in the last decade has stimulated a debate aimed at understanding whether it is still a useful service for IMF members. This sub-paragraph presents and discusses the arguments made by the IMF at the time of the last review and used to explain the retaining of the facility. An initial useful point of reference to be borne in mind is that the 2004 decision to keep the facility was taken even after evaluating three types of recommendations for CFF revision made by the WTO (2002), UNCTAD (2003 and 2007) and FAO (2002).

The first recommendation made by these organisations regards the payments which, according to the WTO and UNCTAD, have to be concessional in order to help those LICs dealing with shocks better. It is worth noticing that IMF members often suffer from other BoP problems and, therefore, CCF funds have to be transferred in conjunction with an upper credit tranche-type arrangement. In such a case, the PRGF offers more flexible answers than the conditional CFF (IMF, 2004a). Indeed, the possibility of borrowing at concessional terms is guaranteed, for instance, by an augmentation under a PRGF which is more appropriate than a CFF because it covers a wider range of shocks and is concessional (IMF, 2004a and 2005). Therefore, the IMF response to the WTO, UNCTAD and FAO seems to be that CFF conditional loans do not necessarily mean that LICs cannot borrow at more concessional terms. Indeed, as discussed above, LICs apply for PRGF support. Implicitly, these IMF arguments seem to indicate that the CFF remains a facility for all IMF members, except LICs.

The second recommendation was that the import coverage of CFF should include all basic foodstuffs and not only cereals. According to IMF staff, one reason not to include other staples in the CFF is the availability of data needed for CFF calculation. Moreover, the IMF recognises that the

“CFF is not the appropriate instrument to deal with the balance of payment costs of adjustment to permanent changes in relative prices and market access associated with trade liberalization” (IMF, 2004a, page 17),

which, on the contrary, represent some of the aims of the Trade Integration Mechanism activated by the IMF itself¹⁴.

The third and final recommendation is that payouts should be automatically linked to specific occurrences (in the sense that the facility should operate on the basis of real time instead of *ex-post* mechanisms) and conditions for stand-alone CFF purchases should disappear. The IMF's reply to these recommendations is that, in the spirit of the 2000 CFF revision, the speed of response to shocks is ensured by stand-alone CFF purchases which are conditional on the fact that, apart from the effect of the temporary shock, a country's balance of payment position is satisfactory. According to IMF staff, relaxing this condition would make compensation more automatic and would probably increase the demand for the CFF, but the IMF intends to maintain the requirement because it limits adverse selection problems in the sense that resources from an unconditional facility might be directed towards developing countries that are not willing to adopt adjustment policies. In other words, the strengthened requirements introduced at the time of the CFF revision are consistent with the Fund's mandate to support orderly BoP adjustments with appropriate safeguards to Fund resources and, therefore, should be retained¹⁵.

After having taken into consideration the above recommendations and even after realising that the premises (temporariness of shocks and absence of alternative facilities) on which the CFF is based are only partially satisfied (IMF, 2003 and 2004a)¹⁶ and, therefore, that

¹⁴ The Trade Integration Mechanism (TIM) was introduced in April 2004 to assist member countries in meeting BoP shortfalls which might result from multilateral trade liberalization. The TIM is not a special lending facility, but rather a policy designed to make resources more predictably available under existing IMF facilities (www.imf.org).

¹⁵ With respect to CFF conditionality, Hewitt (2007) argues that it is the main motivation for the limited use of the IMF's CFF. If, for the first 20 years of application, the condition to cooperate with the Fund was a "*loose gentlemen's agreement*" (Hewitt, 2007, page 3), since the early 1980s the CFF has been included in all IMF systems of conditionality. Similar comments against conditionality have been expressed by many others experts (see above all, Griffith-Jones and Ocampo (2008), Martin and Bargawi (2005) and Tabova (2005).

¹⁶ The appropriate policy dealing with temporary shocks is financing rather than adjustment. However, commodity prices exhibit a declining long-term trend and very frequent/persistent short-term deviations from this trend. On one hand, this means that a mix of financing and adjustment is the appropriate

there are substantial clear arguments for its removal, the IMF staff “does not see this as an urgent matter” and concludes that

“there is some value in maintaining the facility in its current form while other financing instruments to help low-income member countries cope with shocks are being developed” (IMF, 2004a, page 18). Again,

“just as abolishing the CFF would seem to come with little cost to the Fund or its members, the same applies to keeping the CFF” (IMF, 2004a, page 18).

But, what are the reasons behind the Fund’s position? One declared argument refers to the fact that the CFF might be used to assist members in a transparent way and with resources that are to be considered additional to those under other IMF facilities (IMF, 2004a). Furthermore, the IMF insists on saying that, if a member’s BoP position is satisfactory, except for the impact of the shock, the CFF may offer fast assistance with weak conditionality. At the same time, by referring to middle-income countries, it said that international liquidity constraints have been relaxed and these countries may resort to private financing capital or, when that is not enough, to credit tranches under SBAs, which the IMF itself considers

“very suitable to be used in the face of temporary BoP shocks” (IMF, 2004a, page 18).

It seems that the 2004 decision to keep the CFF was made without providing convincing reasons. The maintaining of the CFF would seem to be part of a wait-and-see attitude adopted by the IMF in order to decide about the usefulness of the facility when the review of the entire structure of IMF lending instruments is concluded.

To end this discussion, it is extremely important to point out that, as is documented above, since the last CFF review, IMF members have continued not to use the facility and, therefore, it is time that IMF staff re-examined the proposal to abolish, as announced by the IMF itself in 2004 (IMF, 2004, page 19, and 2004b), or radically

response to shocks while, on the other, it implies that the “*CFF may not be a suitable instrument to deal with a large part of the shocks for which the CFF is mostly used*” (IMF, 2004a, page 10).

revise the facility. Under the current arrangements, the CFF serves no useful purpose and is not an attractive option for LICs given its non-concessional nature.

2.5 Behind the Non-use of the CFF from 2000 onwards

This sub-paragraph summarises the two key elements explaining the lack of use of the CFF. The first main caveat of the facility is that the CFF interest rate, currently 3.05 per cent per annum, is certainly more favourable than that available from commercial banks for most LDCs. However, the CFF interest rate is higher than that of the IMF's PRGF, under which the IMF expects most LDCs to borrow. Secondly, and as mentioned in several parts of this paper, a shortcoming of the CFF is that it requires conditionality: CFF funding is non-concessional and over time the CFF has been modified to increase conditionality (requiring accompanying reforms through a specific IMF arrangement). IMF loans are usually provided under an arrangement which sets out the policies that a country intends to pursue and which forms the basis of access to the loan. Arrangements are based on economic programmes formulated by countries in consultation with the IMF. Loans are then disbursed in instalments as the programme is implemented. As a result of the CFF 2000 revision, conditionality has been increased. Access to the CFF will now be generally available only in the context of an arrangement.

This also holds true because the stand alone CFF purchases, i.e. the low conditional assistance under the CFF, may be used by countries with a viable Balance of Payments position (except for the effects of the export side shocks). The crucial point is that these CFF-eligible countries would normally have access to alternative sources of finance (SBA, emergency assistance and, if they are LICs, PRGF\ESF). Furthermore, countries experiencing structurally weak Balance of Payments usually have other forms of Fund financing such as the PRGF or emergency assistance (IMF, 2004c and 2007).

Although a detailed assessment of IMF conditionality goes beyond the aims of this paper, it appears useful to remember that, at the time of writing, the IMF is concluding a review of all lending instruments and conditionality.

This IMF review will only cover conditionality attached to IMF loans used by middle-income countries. Compared to the last conditionality review, conducted between 2001 and 2003, this review

is secretive, with no public consultation period, no open meetings and no discussion with external stakeholders. IMF staff is also preparing two papers on the IMF's lending instruments – one on middle-income countries and one on LICs. Despite a controversial report on structural conditionality released by the IMF's Independent Evaluation Office in 2007 (IMF, 2007), the financial crisis programmes show that traditional conditionality requiring strict fiscal adjustments and conditionality is still being used. The number of conditions remains stable at about 17 per programme-year and this evidence contrasts with the IMF's initiative to streamline conditionality. Furthermore, the IOE review reports that IMF conditions continue to be criticised on a country-ownership basis.

The demand is for the setting up of a restricted number of prior actions and performance criteria focussing on reforms at high impact in LICs and limited to the core areas of IMF activities (fiscal and monetary policy, finance and certain aspects of trade) (IMF, 2007, page 19). Indeed, it is argued that only these activities help developing countries to achieve a certain degree of macroeconomic stability of their economy and therefore support their growth and their poverty reduction programmes (IMF, 2008b).

2.6 The Impact of the IMF's CFF on Export Instability

After presenting the CFF operating rules and discussing the recent non-use of the facility by developing countries faced by exogenous shocks, it is useful to summarise the results obtained by economists when analysing the impact of the IMF's CFF. Many scholars have assessed the effect of the CFF in terms of its capacity to stabilise export earnings. In this respect, the first study was that of Finger and Derosa (1980) which considers the 71 developing countries benefiting from CFF compensations over the period 1963-1977. The stabilising impact is measured by comparing an index of instability calculated for export earnings with and without CFF payments. This approach was repeated by Herrmann (1983), who considers 20 developing countries that received CFF assistance over the period 1967-1980, Lim (1991), who updates the analysis to 1987 and considers 60 participating countries, and Herrmann *et al.* (1993), who take into consideration 92 countries receiving CFF payments up to 1987. The results of these studies clearly show that the IMF's CFF failed to reduce the export instability of the developing countries that received compensation for drops in exports. This holds true

regardless of the period of analysis, the method used to measure the short-term instability and the sample of countries covered by the studies¹⁷.

To sum up, the empirical evidence finds that the CFF exerts a limited stabilising impact which the authors all ascribe to the formula used for determining the export shortfall, to the administrative time-lag between the application year and the period in which the payment is made, and to the only partial coverage of the shortfall in exports due to the fact that the member's IMF quota limits the amount which can be withdrawn.

3. COMMODITY-RELATED SCHEME: THE STABEX

The arguments against export earning instability [see, besides many others, the pioneering works by MacBean (1966) and Maizels (1992)] supported past choices made by the EU, when it decided to adopt the STABEX, i.e. the scheme for stabilising the export earnings of countries belonging to the Lomé Convention. STABEX operated from 1975 to 2000 and its aim was to assist ACP commodity exporting countries when they experienced a fall in export earnings in selected agricultural sectors. The basic idea behind STABEX was to settle payments in favour of ACPs in order to compensate for export shortfalls and, therefore, to re-establish the level of earnings which they would have received under normal market conditions. The main provision of STABEX indicates that it was only aimed at reducing the instability and risks faced by commodity-export-dependent ACP states when the shortfall of earnings was substantial and that it generally regarded exports of eligible products to the EU market. Compensation claims by considering commodity exports to all destinations are also possible [Article 197(5) of Lomé Agreement]¹⁸.

¹⁷ Beside the stabilising impact on export earnings instability, some authors have evaluated the role of CFF from a more general perspective. For instance, Herrmann *et al.* (1993) show that, from the national point of view of the recipient country, the CFF has to be evaluated positively. This is due “*to the dominant impact of the transfers benefits the countries realised*” and implies that “*the major incentive to participate in the CFF is the implicit income transfer that the drawing country receives*” (Herrmann *et al.*, 1993, page 83).

¹⁸ STABEX transfers were paid to stabilise the exports of 49 selected commodities, where, as general rule, compensation could be claimed for exports from each ACP to EU [Article 197(5) of Lomé Agreement]. The scheme was

When it was implemented, STABEX was considered to be highly innovative because its micro-based rules, in the sense that it was to be aimed at selected products, were relevant to the export structure of each ACP. The implicit rationale of STABEX was based on the following virtuous circle: when the EU-ACPs channelled funds towards commodities whose exports were unstable but important for the country concerned and these financial resources were used in the sector which suffered the shortfall in revenue, then STABEX contributed to reducing the total EEI and, *ceteris paribus*, to raising national long-run growth.

3.1 The Failure of STABEX

In what follows, we briefly comment on certain STABEX mechanisms which have conditioned its effectiveness. This is done to see whether any policy implications might be derived from a study of the workings of the main stabilising scheme implemented by the EU: future EU-ACP relationships might profit from what can be learnt from the past¹⁹.

The aspects which are considered here are specific to STABEX and regard the composition of the basket of goods which benefit from transfers and the use of these transfers in the specific sector for which they had been claimed²⁰. One would expect that, *ceteris paribus*, the greater the number of products covered by STABEX is, the greater the observable effect will be at the level of total exports and, therefore, the greater the impact will be on ACP growth (Aiello,

activated if: (a) the exports of an eligible product represented at least 5.5% of total exports from an ACP (*dependence threshold*). The full dependence threshold was applied only for 12 ACPs, because the reduced 1% threshold was applied to least-developed and/or landlocked and/or islands; (b) the exports to the EU market (or to all destinations, in specific cases) of any STABEX product were at least 6% below the reference level (*fluctuation threshold*); (c) instability did not depend on the operating of commercial policies which discriminated against the EU.

¹⁹ For a discussion on STABEX, see, above many others, Aiello (1998, 1999a, 1999b, 2002), Herrmann *et al.* (1993), Hewitt (2007) and Lim (1991).

²⁰ STABEX also exerted a limited stabilising impact because of the substantial delays in payments made by the EU. These delays make STABEX less effective and, sometimes, pro-cyclical rather than countercyclical (Brun *et al.*, 2001). The stabilising impact of STABEX is detailed in Aiello (1999a). See also Lim (1991).

1999b and 2002; Lim 1991). On the other hand, the logic underlying the STABEX aim to stabilise earnings from exports of each product requires that compensations are transferred to the sector concerned in order to allow producers both to reorganise production and to improve their investment planning. This also remains one of the key recommendations on commodity issues by the panel of eminent persons organised by UNCTAD in 2003. They suggested the inclusion of a

“pass-through mechanism to actual producers and consumers”

within a facility aimed at

“insulating developing countries from the worst effects of international price volatility” (UNCTAD, 2003).

3.1.1 STABEX Product-coverage

One of the most controversial and highly debated aspects of STABEX was its product coverage. The aim of the EU-ACP agreement was to provide financial support to the exports of traditional commodities, in particular tropical tree crops, upon which many ACPs, as exporters, and EU countries, as importers, were dependent. It would appear, however, that the basket of products covered by STABEX (29 in Lomé I and 49 in Lomé IV) might have put ACP countries at a disadvantage. In fact, ACPs had incentives to achieve certain levels of production and exports in the selected sectors in order to satisfy the qualifying criteria of STABEX and then claim compensation. Yet it was unclear what the economic justification was for excluding various products (sugar, meat and tobacco) from the stabilisation scheme which were (and are) crucial for many ACPs (Botswana, Fiji, Guyana, Jamaica, Malawi, Mauritius, Swaziland, Zimbabwe)²¹. One consequence of the fact that the basket

²¹ This choice can certainly not be justified on the grounds that certain products (meat and sugar) were included in preferential commercial agreements because the preferential policies were not concerned with export instability and, even if this had not been the case, it would be difficult to understand the inclusion of bananas to which Lomé granted a specific protocol. The paradox surrounding the exclusion of these products can be highlighted by recalling the guiding principle for the formation of the STABEX basket of goods, which was to “take account of employment, of the deterioration of the terms of trade between the EU and ACPs, on the level of development in the latter as well as the difficulties of isolation faced by less developed ACP states” (Art. 17, Lomé I).

of goods covered by the system was tilted in favour of certain tropical agricultural products was the way STABEX payments were distributed on a country and/or product level. As STABEX worked it was of doubtful utility because of the compensations made in favour of the biggest and the richest ACPs. These doubts increase when one considers that from Lomé IV the STABEX payments were grants.

3.1.2 Use of Funds

Another characteristic of STABEX that requires a very brief discussion is the utilisation of transfers by the beneficiary countries. The flexibility in allocating compensation has been accompanied by certain discretion in the fund management by the ACPs. It is reasonable to consider that, from the point of view of the individual country, the lack of constraints in the regulations on how to use the transfers did not represent a problem, since, given currency shortages, BoP and debt problems, a government's aim was to increase the acquisition of foreign currency, whatever the source. Operating in this way, however, the EU can be considered equally responsible for a process which generated an inaccurate perception of variability in export earnings: ACPs linked the wide variations in revenues from exports with the resultant transfers from the EU. In other words, the ACPs saw STABEX as an additional aid window, not as a stabilisation device. It is quite clear that this worked as a disincentive to the imposition of policies aimed at removing the domestic causes of instability.

4. FLEX: THE NEW FACILITY PROVIDING FINANCIAL SUPPORT TO ACPs

Bearing in mind the lessons learnt in the past, in 2000, the EU set up a new programme, the FLEX, which was intended to be wider and simpler than STABEX. FLEX was introduced within the framework of EU-ACP cooperation and its motivation is clearly explained in the following:

“The parties recognise that instability of export earnings, particularly in the agricultural and mining sectors, may adversely affect the development of ACP States and jeopardise the attainment of their development requirements. A system of additional support in order to mitigate the adverse effects of any instability in export earnings, including in the agricultural and mining sector, is therefore set up

within the financial envelope for support to long-term development” [Article 68(1) of the 2005 revised Cotonou Agreement].

This article confirms the EU-ACP orientation towards provision of financial assistance to developing countries whose development process is hindered by the variability of their export earnings. To be more precise, the declared scope that EU and ACPs want to pursue through FLEX is defined as follows:

“The purpose of support in cases of short term fluctuations in export earnings is to safeguard socio-economic reforms and policies that could be affected negatively as a result of a drop in revenue and to remedy the adverse effects of instability of export earnings, in particular from agricultural and mining products” [Article 68(2) of the 2005 revised Cotonou Agreement].

In brief, FLEX is a facility which mobilises additional resources from a country ‘B’ (nonprogrammable) envelope if certain qualifying conditions are met. As will be discussed later, these eligibility criteria regard the magnitude of the shock, in the sense that the loss of export earnings must be above a given threshold, and, up to 2008, the effect of the shock on the public deficit of the ACP concerned. If the country is eligible, then funds will be provided in swift-disbursing form, as budget support, so as to guarantee counter-cyclical fiscal relief.

Because of reasons that will be explained in the following discussion, these eligibility criteria were revised in 2004 and 2008. In what follows, we briefly describe some of the facility’s basic operational rules, as they were established in the initial FLEX and the 2004 revision, whereas the 2008 revision will be thoroughly documented, given that it regards how FLEX currently works.

4.1 Eligibility Criteria for FLEX Support in 2000

From 2000 until the 2004 revision, FLEX payments were activated if, in the application year N, export earnings from goods were 10% (2% for LDCs) below the reference level. Alternatively, ACPs could claim assistance if a sudden drop of 10% (2% for LDCs) in earnings related to the total for agricultural or mineral products and these sectors were considered to be highly relevant for that particular ACP economy (the exports from these sectors had to represent at least 40% of national exports) (Annex II, art. 9(1/a) of the Cotonou Agreement). Whatever the export aggregation (total exports

or agricultural/mineral exports), the reference level was determined as the arithmetical average of earnings in the years N-4 to N-2. Furthermore, it was required that the drop in export earnings caused a worsening of 10% in the programmed public deficit either for the year of application or for the successive one [Annex II, art. 9(1/b) of the Cotonou Agreement].

ACPs that met the qualifying criteria had access to FLEX support for a maximum four successive years (Annex II, art. 9(2) of the Cotonou Agreement). As for the use of financial support, the ACP-EU agreement established that the additional funds should be reflected in the ACP country's public account. The general rule was that the use of resources ought to be made in accordance with the programming rules and methods, as jointly established by the EU and the beneficiary ACP, and had to address finance activities included in the national budget (Article 9(2) of the Annex IV of the Cotonou Agreement). However, beneficiaries could devote FLEX funds to other uses, although the agreement was vague in specifying what the alternative uses of the financial support were

“a part of additional resources may be set aside for specific sectors”
[Annex II, art. 9(3) of the Cotonou Agreement].

4.2 The 2004 and 2008 FLEX Revisions

Evidence from the past shows that the initial eligibility criteria were too stringent, resulting in relatively few ACP countries being considered eligible. This is why FLEX has already been revised twice, in 2004 and 2008. Both revisions aimed at improving the functioning of FLEX, in the sense of simplifying the eligibility criteria, so the facility effectively pursued its objectives. It is worth noticing that the revisions did not regard the main principle of the instrument, i.e. financial assistance to cover for losses in Government revenues as a consequence of a shortfall in export earnings (European Commission, 2004b).

From the experience of applying FLEX in its initial years of implementation (2000-2002), it emerged that few countries applying for FLEX support met the eligibility criteria²². Modification of

²² See at http://europa.eu.int/comm/trade/issues/global/development/pr120204_en.htm or § 5.2 of this paper.

the facility was, therefore, proposed (European Commission 2004a and 2004b). By taking into account the proposal made by the EU Commission, the EU-ACP revised the terms and conditions of financing for fluctuations in export earnings in 2004 (ACP-EC Council of Ministers, 2004).

The main change made in 2004 regarded the reduction from 10% to 2% of the increase that ACPs had to register in their public deficit as a result of export side exogenous shocks. Furthermore, the special clause applying to LDCs was extended to landlocked countries and island states, lowering the eligibility threshold to a 2 per cent loss in export earnings²³.

Had the proposed criteria been applied from 2000-02, ACP states would have received 255 million euro from FLEX, six times more than the amount actually disbursed (DFID, 2004; European Commission, 2004a).

FLEX was amended again with Decision No. 1/2008 of the ACP-EC Council of Ministers of 13 June 2008 (ACP-EC Council of Ministers, 2008). While this revision started with the suggestion made by the ACP group in January 2005 to amend FLEX, the EU Commission and the ACP countries agreed²⁴ that the proposal would be examined later because the

“amendment was not dealt with in the framework of the five-year revision of the Cotonou Agreement” (European Commission, 2007, page 2).

Below, we document and discuss the main features of the last revision. The first aspect to be pointed out concerns the fact that the eligibility condition triggered to the magnitude of the shock remains

²³ In 2005, the new paragraph 3 of Article 68 of the revised Cotonou Agreement extended to “*post conflict and post natural disaster ACP States*” the more favourable treatment in the allocation of resources, as already established for least developed, landlocked and island countries because of their extreme dependence on exports (ACP-EC Council of Ministers, 2005). This extension also regards eligibility for FLEX support, as regulated in the 2008 FLEX revision (ACP-EC Council of Ministers, 2008; European Commission, 2007).

²⁴ Declaration II of the Final Act of the Agreement signed in Luxembourg on 25 June 2005 - Joint declaration on Article 68 of the Cotonou Agreement: “*The ACP-EC Council of Ministers will examine, in application of the provisions contained in Article 100 of the Cotonou Agreement, the proposals of the ACP side concerning Annex II thereof on short-term fluctuations in export earnings*”.

the same with respect to the rule established in the 2004 revision²⁵. For ease of exposition and in order to save space, we summarise the main changes in the 2008 FLEX in the following points:

- i) the decision to eliminate the eligibility criterion concerning a worsening in programmed public deficit;
- ii) the exclusion of the most extreme year from calculation of the reference value needed to measure shock size;
- iii) the rule that limits access to FLEX support to three successive years rather than four years, as it was in the past;
- iv) the method of calculating and mobilising FLEX support.

There are several reasons for abolishing the eligibility criterion relating to the impact on public deficit. For instance, the EU Commission argues that there are some difficulties in establishing the impact of shortfalls in export earnings on government budgets, because the country-by-country variations of tax systems may influence the period (N+1, N+2) when the impact of a shock to the public budget occurs. Furthermore, the impact may be influenced by macroeconomic management and the grip on public finances. Therefore, if countries' circumstances cause differences in the effective impact of a shock, than the second eligibility criterion might favour ACPs with less rigorous management of public finances. Finally, the arbitrary 2 per cent worsening of the deficit eligibility threshold might alter results, in the sense that countries with small programmed deficit may enjoy easier access, *ceteris paribus*, FLEX support than countries with substantial programmed deficit (European Commission, 2007).

As for calculating the reference value, the method used since 2000 has been the arithmetic mean of the exports over the years T-4 to T-2. With the 2008 revision, the reference level is calculated considering the years T-4 to T-1, excluding the most extreme year. This final amendment differs from the initial ACP proposal to consider a six-year reference period, excluding the highest and lowest

²⁵ A country may apply for compensation if it registers a 10% loss in export earnings (2% in the case of LDCs, landlocked, island, post-conflict and post-natural disaster States) with respect to the export reference value. The loss of 10% (2%) may be determined by taking into account the total agricultural/mineral exports given the condition that exports on the part of these sectors represent more than 40% of total national exports, or they are between 20% and 40%, provided that total earnings do not increase more than proportionally with respect to the impact of the loss of export earnings.

values. As argued by the EU Commission (European Commission, 2007) a six-year reference period may reflect a structural trend against the focus of FLEX on short-term instability.

While the removal of the public deficit condition makes access to FLEX less restrictive than before, a minimum impact threshold has, at the same time, been established: the 2008 revised FLEX states that the drop in export earnings

“must be 0.5% of GDP or more for there to be entitlement to additional support²⁶. Entitlement to additional support shall be limited to three successive years” [Revised Article 9(2) of Annex I to the Cotonou Agreement].

It is important to notice that the introduction of the minimum impact threshold is made with the intention of avoiding the risk of a proliferation of small compensations not helping the beneficiary countries in their macroeconomic stability and development processes, while the reduction in the successive years of eligibility is more in line with the purpose of FLEX, in so much as it is a facility dealing with short-term instability resulting from international business cycles and not with structural declining trends of export earnings.

Moreover, the new FLEX addresses the issue of how the amount of additional financial support is to be determined. In the revised FLEX, the amount of aid support, i.e. the theoretical effect of the export shortfall on the public budget, is calculated as the product of the loss of export earnings in the application year and the “government revenue/gross domestic product ratio” averaged over the four years preceding the application year, excluding the most extreme value and capping this ratio at 25%. While the method of calculating the effects of the shock reflects the difficulties above discussed in using the budget deficit as a reference point, the cap of 25% is expected to help ACPs which are less well-armed against export side shock and, in particular, the

“countries with relatively weak central government revenue excluding grants” (European Commission, 2007, page 6).

Another important novelty in the 2008 revision regards the method of allocating financial support. Up to 2008, ACPs eligible for

²⁶ This percentage is smaller than that (0.7%) included in the proposal for a Council decision developed by the EU Commission in 2007 (European Commission, 2007).

budgetary support received FLEX assistance as a general budgetary support, while, for ACPs not eligible for budgetary support, FLEX financial assistance is added to the Country Indicative Programme (NIP) in order to finance new initiatives or to top up existing projects and programmes. For this later group of countries, FLEX assistance

“does not contribute directly to macroeconomic stabilization and is not truly counter-cyclical in nature” (European Commission, 2007, page 7).

Up to 80% of potential financial assistance could be disbursed in advance. In the 2008 revision, it was decided to increase the level of these advances up to 100% and to introduce a specifying rule according to which advances are reserved for countries “where FLEX financial support can be implemented by means of general budgetary support”. Therefore, the increase in the advances to 100% should guarantee a reduction in the disbursement period²⁷, whereas, the possibility of claiming payment in advance is restricted to those countries which aim to use the additional support as budgetary support, something which is strictly in line with FLEX objectives. The allocation of FLEX support to ACPs not eligible for budgetary support is allowed only after the shortfall in export earnings is documented with final statistics.

Finally, it is worth mentioning that the 2008 revision stresses the orientation according to which FLEX transfers should be used to

“develop market based insurance schemes offering protection against the risk of fluctuations in export earnings” [Article 9(3) of the Annex to the Cotonou Agreement].

The focus on market based insurance and on other alternative uses of funds has been allowed since 2000 (“a part of additional resources may also be set aside for specific sectors”), but the 2008 revision specifies this point.

The elaborations of data from the EU Commission allow for an

²⁷ The timing of FLEX support is expected to be as follows: final date for FLEX requests in the first half of year N+1 and the EDF Committee decision and the consequent disbursement to be made in the latter half of the same year or, at the latest, at the beginning of year N+2. Offsetting the amount disbursed against the next payment of budgetary support would then allow any over-payment (if final statistics show that the loss of export earnings was not as large as forecast) to be recovered at a later date.

evaluation of how FLEX worked over the period 2000-2007. The discussion made in the next section will permit the understanding of:

- i) the frequency of export side shocks;
- ii) whether, and to what extent, the criteria for being eligible for FLEX support have been stringent;
- iii) the availability of finance with respect to the demand for support from ACPs;
- iv) the promptness of the disbursements made by EU.

5. THE WORKING OF FLEX

This section describes the working of FLEX over the period 2000-2007. By taking into account the countries which documented at least one drop in export earnings from 2000 to 2007, Table 1 presents the figures regarding the shortfall of export earnings, the impact on public deficit (up to 2006) and the actual FLEX support. This information allows us to evaluate whether and to what extent ACP countries meet the first eligibility criterion relating to the relevance of the shock (first and second columns of data for each application year from 2000 to 2006) and the second condition regarding the impact on the public budget (third and fourth columns of data for each application year from 2000 to 2006). Furthermore, Table 1 helps the understanding of other issues (for instance, the distribution across country and over time of the shocks and of the FLEX support, the financial coverage of FLEX) relating to the working of the EU facility.

Given that the 2008 FLEX revision abolished the criterion relating to the impact on public deficit, the information available, at the time of writing, for the application year 2007 (European Commission, 2009) regards the qualifying condition relating to the magnitude of the shock, and the FLEX support. Finally, in the last column of data, we report the effective FLEX support received by each ACP economy for each year. For better interpretation and comparison of the results from 2000 to 2007, it is necessary to bear in mind:

- i) the 2004 and 2008 revisions, which, as has been pointed out, have changed the eligibility criteria ACPs have to meet in order to claim for FLEX support;
- ii) the changes in the availability of financial resources for additional support. In this respect, it should be mentioned that

additional funds have been allocated to set up an intra-ACP FLEX programme of 50 million euro for 2006 (application year 2005) and of 50 million euro for 2007 (application year 2006). From application year 2007 on, the amount of FLEX support available will be 80-100 million euro for each year²⁸ and

“this amount corresponds to a coverage of about 35% to 45% of estimated effective needs of the application years 2004-2005-2006” (European Commission, 2007).

5.1 *The Instability of ACP Export Earnings*

The first question to be addressed is the relevance of short-term instability in ACP export earnings. Do ACPs suffer as a result of export side shocks? How much do they suffer? What is the distribution of export shocks across ACP countries and over time?

An initial response is given by the number of countries that report statistics on export earnings in order to apply for FLEX support: they number 47 out of 78 ACP states²⁹ and therefore there are 31 countries whose exports do not show a significant negative deviation from the reference value for each year of the period under scrutiny³⁰.

²⁸ As is stated in the Decision No. 1 of the ACP-EC Council of Ministers of 25 May 2007, these additional funds are for “ensuring minimal support to those countries subject to the adverse effects of instability in export earnings regardless of the level of the uncommitted balances under their national B-envelopes before the end-of-term review reallocation decision entered into force”.

²⁹ Antigua and Barbuda, Belize, Benin, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Comoros, Cook Islands, Ivory Coast, Dom. Republic, Dominica, Eritrea, Ethiopia, Fiji, Gambia, Grenada, Ghana, Guinea-Bissau, Guyana, Jamaica, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Niger, Papua New Guinea, Rwanda, Sao Tome and Prince, Samoa, Senegal, Solomon Islands, St. Lucia, St. Kitts and Nevis, St. Vincent/ Grenadines, Sudan, Suriname, Swaziland, Tanzania, Tonga, Uganda, Vanuatu, Zambia, Zimbabwe.

³⁰ This result has been interpreted cautiously because our data refer only to countries which present statistics in order to apply for FLEX support. However, if on one hand it is not possible to know from this dataset whether there are other ACPs suffering from drops in export earnings, on the other hand, it is reasonable to argue that the group not claiming FLEX support includes countries which might have experienced just a small shortfall in

Some other insights may be obtained by looking at the distribution of shocks across countries and years. Within the group of countries reporting at least one shortfall in exports, there are 12 economies whose exports show a negative deviation from the trend for just one year³¹. 5 ACPs suffered a shock in export earnings for two different years, whereas the number of ACPs affected by export shocks for three years is 9³². Only 11 out of the 47 shock-suffering ACPs register a drop in exports for more than four years. To be more precise, Dominica and Malawi suffered from export shocks in 7 years over the period 2000-2007, Guyana, Ivory Coast and St. Lucia in 6 out of 8 years and 6 economies (Burundi, Central Africa Republic, Ethiopia, Madagascar, Mali and Zimbabwe) recorded a shock in 5 out of 8 years (Table 1).

From the data reported in Table 1, it is also possible to point out that export earnings instability exhibits some differences from one year to another. From 2000 to 2007 the total number of documented reductions of ACP exports was 151. The year with the maximum number (27) of shocks was 2003 whereas the minimum was 14 in 2005 (see also Table 2).

According to the above discussion, it is reasonable to argue that

- (a) export earnings instability appears to be an issue for a restricted number of ACPs and
- (b) the frequency of shocks by country indicates that only in a few cases do exports show regular negative deviations from the reference value.

The majority of ACPs register temporary shortfalls in exports earnings, and it is these that FLEX aims to deal with.

export earnings. Indeed, had the shock been large in magnitude (i.e., the exports showed a significant negative deviation from the reference value), the ACP would have an incentive to report the exports statistics and, therefore, apply for additional FLEX support.

³¹ Antigua and Barbuda (in 2003), Botswana (in 2003), Burkina Faso (in 2002), Cook Islands (in 2007), Eritrea (in 2003), Fiji (in 2004), Jamaica (in 2003), Mozambique (in 2002), Papua New Guinea (in 2003), Senegal (in 2003), Suriname (in 2002) and Zambia (in 2000, Table 1).

³² Countries suffering an export earnings shortfall in two years: Chad, Ghana, Rwanda, St. Vincent/Grenadines and Sudan. Countries suffering a shortfall in export earnings in three years: Belize, Comoros, Dominican Republic, Grenada, Sao Tome and Prince, Samoa, Swaziland, Tanzania and Tonga (Table 1).

TABLE 1 - *Export Earnings Instability of ACP States and FLEX Support. Eligibility Criteria and Financial Support to Individual Country over the Period 2000-2007*

| Countries | Application Year 2000 | | | | Application Year 2001 | | | | Application Year 2002 | | | | | |
|-----------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|----------------------------------|--------------------|
| | Shortfall in Export Earnings ^s | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Actual FLEX Support ^t | |
| | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | Absolute Value | in % (I Criterion) |
| 1 | Antigua & Barb. | | | | | | | | | | | | | |
| 2 | Belize | | | | | | | | | | | | | |
| 3 | Benin (PMA) | | | | | | | | | | | | | |
| 4 | Botswana | | | | | | | | | | | | | |
| 5 | Burkina Faso | | | | | | | | | | | | | |
| 6 | Burundi | 5,59 | 10,13 | 0,87 | 1,8 | 19,37 | 31,02 | 3,18 | 12,92 | 17,31 | 10,44 | 2,27 | 0,75 | |
| 7 | Central Afr. Rep. | | | | | | | | | 24,51 | 47,48 | 4,29 | 8,21 | |
| 8 | Chad - Tchad | 12,47 | 5,91 | 0,13 | 0,77 | 38,28 | 17,06 | 0,4 | 0,23 | 3,1 | 5,2 | 0,3 | 0,2 | |
| 9 | Comoros | | | | | | | | | | | | | |
| 10 | Cook Islands | | | | | | | | | | | | | |
| 11 | Ivory Coast | 42,9 | 2,1 | | | 66,4 | 3,2 | | | | | | | |
| 12 | Dom. Republic | 51,58 | 15,98 | 8,01 | 1,85 | 32,33 | 10,85 | 5,15 | 1,11 | | | | | |
| 13 | Dominica | 0,33 | 1,65 | 0,1 | 0,24 | 4,7 | 22,6 | 1,5 | 5,1 | 5,48 | 10,8 | 1,63 | 7,45 | |
| 14 | Eritrea | | | | | | | | | | | | | |
| 15 | Ethiopia | 10,67 | 2,85 | 1,42 | 0,2 | 104,54 | 26,85 | 15,33 | 2,42 | 27,18 | 7,47 | 4,26 | 1,25 | |

Table 1 - (continued)

| Countries | Application Year 2000 | | | | Application Year 2001 | | | | Application Year 2002 | | | | | |
|---------------------------------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|----------------------------------|--|
| | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Actual FLEX Support ^t | |
| | Absolute Value | (I Criterion) in % | Absolute Value | (II Criterion) in % | Absolute Value | (I Criterion) in % | Absolute Value | (II Criterion) in % | Absolute Value | (I Criterion) in % | Absolute Value | (II Criterion) in % | | |
| 31 Rwanda | | | | | | | | | | 5,53 | 11,59 | 0,56 | 0,29 | |
| 32 Sao Tome & P. | 1,21 | 29,66 | 0,15 | 0,42 | 0,97 | 24,96 | 0,12 | 0,26 | | | | | | |
| 33 Samoa | | | | | | | 31,07 | | | | | | | |
| 34 Senegal | | | | | | | | | | | | | | |
| 35 Solomon Islands ^b | 56,7 | 44,77 | 13,42 | 516,09 | 71,25 | 58,8 | 17,65 | 70,59 | 4,12 | 21,74 | 30,12 | 5,14 | 10,23 | |
| 36 St Lucia | | | | | 7,76 | 20,09 | 1,91 | 3,05 | | 8,78 | 16,9 | 2,29 | 5,57 | |
| 37 St. Kitts & Nevis | 3,89 | 34,36 | 1,2 | 4,95 | 2,12 | 20,85 | 0,65 | 1,8 | | | | | | |
| 38 St. Vincent/Gren. | | | | | | | | | | | | | | |
| 39 Sudan | | | | | 79,06 | 20,48 | 6,03 | 4,61 | | | | | | |
| 40 Suriname | | | | | 31,6 | 7,1 | 8,2 | 19,7 | | | | | | |
| 41 Swaziland | 6,8 | 3,50 | 2 | 2,5 | | | | | | | | | | |
| 42 Tanzania | | | | | | | | | | 53,28 | 13,16 | 6,4 | 0,5 | |
| 43 Tonga | 0,61 | 7,57 | 0,2 | 0,4 | 1,43 | 14,89 | 0,4 | 0,5 | | | | | | |
| 44 Uganda | 309,8 | 46,61 | 36,05 | 4,91 | 192,26 | 33,95 | 22,43 | 2,96 | | 63,6 | 13,2 | 7,44 | 0,87 | |
| 45 Vanuatu | 1,15 | 4,99 | 0,27 | 6,1 | 7,45 | 29,6 | 1,7 | 71,86 | 1,7 | 8,24 | 24,95 | 1,8 | 68,49 | |
| 46 Zambia | 58,01 | 6,61 | 11,49 | 11,3 | | | | | | | | | | |
| 47 Zimbabwe | | | | | | | | | | 477 | 24,95 | 132,4 | 4,7 | |
| Total | 823 | | 151,6 | | 19,25 | 1042,03 | 203,66 | | 12,77 | 954,3 | 205,2 | | 3,6 | |

TABLE 1 - (continued)

| Countries | Application Year 2003 | | | | Application Year 2004 | | | | Application Year 2005 | | | | |
|------------------------|---|-----------------------|---|------------------------|---|-----------------------|---|------------------------|---|-----------------------|---|------------------------|----------------------------------|
| | Shortfall in Export Earnings ^a Absolute Value | in % (I Criterion) | Impact on public deficit ^a Absolute Value | in % (II Criterion) | Shortfall in Export Earnings ^a Absolute Value | in % (I Criterion) | Impact on public deficit ^a Absolute Value | in % (II Criterion) | Shortfall in Export Earnings ^a Absolute Value | in % (I Criterion) | Impact on public deficit ^a Absolute Value | in % (II Criterion) | Actual FLEX Support ^b |
| 16 Fiji | | | | | 47,4 | 9,60 | 12,06 | 17,20 | 2,1 | | | | |
| 17 Gambia | 10,34 | 75,4 | 1,8 | 15,8 | | | | | | | | | |
| 18 Grenada | | | | | | | | | | 23,98 | 58,3 | 6,43 | 10,4 |
| 19 Ghana | | | | | 52,83 | 6,67 | | | | | | | |
| 20 Guinea-Bissau | 10 | 19,0 | 2 | 31,8 | 6,9 | 12 | 1,2 | 8,00 | 1,2 | | | | |
| 21 Guyana ^b | 64,61 | 12,3 | 19,97 | 13,51 | 87,87 | 16,23 | 27,8 | 23,21 | 73 | 14,2 | 23,07 | 15,9 | 6,13 |
| 22 Jamaica | 323,96 | 30,1 | 95 | 52,8 | | | | | | | | | |
| 23 Madagascar | 60,75 | 12,8 | 6,7 | 1,5 | 140,26 | 27,40 | 13,93 | 2,98 | | 227,29 | 57,2 | 21,52 | 5,1 |
| 24 Malawi | 48,95 | 10,8 | 8,76 | 3,8 | 115,15 | 24,05 | 20,27 | 7,55 | 1,24 | 16,36 | 3,6 | 3,07 | 1,1 |
| 25 Mali | | | | | 85,6 | 17,20 | 11,5 | 5,70 | 1,11 | | | | |
| 26 Mauritania | 79,21 | 21,1 | 19,79 | 71,29 | 85,6 | 22,86 | 21,28 | 108 | | 11,88 | 7,9 | 3,24 | 5,3 |
| 27 Mauritius | 90,4 | 6,0 | 17,72 | 5 | 233,8 | 14,90 | 44,27 | 13,30 | 0,44 | 391,1 | 24,8 | 73,4 | 24,8 |
| 28 Mozambique | | | | | | | | | | | | | |
| 29 Niger | 28,45 | 37,7 | 1,36 | 0,65 | 34,46 | 41,21 | 3,27 | 1,52 | | | | | |
| 30 Papua N Guinea | 90,38 | 4,4 | 22,44 | 12 | | | | | 22,4 | | | | |

TABLE 1 - (continued)

| Countries | Application Year 2003 | | | | Application Year 2004 | | | | Application Year 2005 | | | | | | | |
|---------------------------------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|---|--------------------|---------------------------------------|---------------------|----------------------------------|------|-------|-----|
| | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Actual FLEX Support ^b | | | |
| | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | | | | |
| 31 Rwanda | 18,48 | 24,6 | 1,8 | 0,93 | | | | | | | | | | | | |
| 32 Sao Tome & P. | | | | | | | | | | | | | | | | |
| 33 Samoa | 3,42 | 21,5 | 0,94 | 16,58 | 0,94 | 4,58 | 27,72 | 1,14 | 12,34 | 1,14 | | | | | | |
| 34 Senegal | 6,79 | 2,2 | 1,2 | 0,61 | | | | | | | | | | | | |
| 35 Solomon Islands ^b | 18,01 | 29,7 | 3,59 | 28,63 | | | | | | | | | | | | |
| 36 St Lucia | 6,32 | 13,3 | 1,68 | 3,08 | 1,68 | 11,5 | 26,60 | 3 | 8,09 | 3 | 10,9 | 25,6 | 2,63 | 9,5 | 0,70 | |
| 37 St. Kitts & Nevis | | | | | | | | | | | | | | | | |
| 38 St. Vincent/Gren. | 15,24 | 35,6 | 4,4 | 15,96 | 4,4 | | | | | | | | | | | |
| 39 Sudan | | | | | | | | | | | | | | | | |
| 40 Suriname | | | | | | | | | | | | | | | | |
| 41 Swaziland | | | | | | | | | | | | | | | | |
| 42 Tanzania | 53,28 | 13,2 | 6,4 | 0,5 | | | | | | | | | | | | |
| 43 Tonga | | | | | | | | | | | | | | | | |
| 44 Uganda | | | | | | 47,58 | 10,06 | 5,6 | 0,76 | | | | | | | |
| 45 Vanuatu | 2,45 | 11,5 | 0,5 | 9,76 | | | | | | | | | | | | |
| 46 Zambia | | | | | | | | | | | | | | | | |
| 47 Zimbabwe | 324,48 | 24,7 | 64,5 | 1,4 | ** | | | | | | | | 432,71 | 53,2 | 61,45 | 7,8 |
| Total | 1575,2 | | 387,1 | | 81,5 | 1134,78 | | 186,59 | | 10,6 | 1110,5 | | 252,65 | | 50,00 | |

TABLE 1 - (continued)

| Countries | Application Year 2006 | | | | | Application Year 2007 | | | |
|-----------|---|--------------------|---------------------------------------|---------------------|----------------------------------|---|--------------------|----------------------------------|-------|
| | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Actual FLEX Support ^a | Shortfall in Export Earnings ^a | | Actual FLEX Support ^a | |
| | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | | Absolute Value | in % (I Criterion) | | |
| 1 | Antigua & Barb. | | | | | | | | |
| 2 | Belize | | | | | | | | |
| 3 | Benin (PMA) | 101,94 | 50,6 | 16,75 | 7,97 | 5,22 | 0,51 | 34,65 | |
| 4 | Botswana | | | | | | | | |
| 5 | Burkina Faso | | | | | | | | |
| 6 | Burundi | | | | | | 4,48 | 14,78 | 0,85 |
| 7 | Central Afr. Rep. | | | | | | 0,01 | 5,80 | |
| 8 | Chad - Tchad | | | | | | | | |
| 9 | Comoros | 12,52 | 61,3 | 2,01 | 8,54 | 0,49 | | | |
| 10 | Cook Islands | | | | | | 2,18 | 15,66 | |
| 11 | Ivory Coast | 260,89 | 12,3 | 45,13 | 56,83 | 10,97 | 114,91 | 8,13 | 20,09 |
| 12 | Dom. Republic | | | | | | | | |
| 13 | Dominica | 6,24 | 17,1 | 1,85 | 99,15 | 0,48 | 0,03 | 13,75 | |
| 14 | Eritrea | | | | | | | | |
| 15 | Ethiopia | | | | | | 0,74 | 0,17 | |
| 16 | Fiji | | | | | | | | |
| 17 | Gambia | | | | | | | | |
| 18 | Grenada | 12,82 | 46,8 | 3,16 | 6,82 | 0,66 | 0,03 | 19,65 | |
| 19 | Ghana | | | | | | | | |
| 20 | Guinea-Bissau | 1,35 | 2,9 | 0,21 | 0,47 | | 10,15 | 21,46 | 1,73 |
| 21 | Guyana ^b | 20,47 | 4,2 | | | | | | |
| 22 | Jamaica | | | | | | | | |
| 23 | Madagascar | 127,39 | 40,8 | 12,87 | 2,66 | 3,12 | 3,73 | 34,43 | |
| 24 | Malawi | 60,09 | 14,3 | 12,30 | 3,25 | 2,82 | | | |
| 25 | Mali | | | | | | 0,04 | 13,72 | |
| 26 | Mauritania | | | | | | | | |
| 27 | Mauritius | 270,80 | 18,5 | 52,54 | 23,90 | 12,65 | | | |
| 28 | Mozambique | | | | | | | | |
| 29 | Niger | | | | | | 0,17 | 42,41 | |

TABLE 1 - (continued)

| Countries | Application Year 2006 | | | | | Application Year 2007 | | |
|-----------|---|--------------------|---------------------------------------|---------------------|----------------------------------|---|--------------------|----------------------------------|
| | Shortfall in Export Earnings ^a | | Impact on public deficit ^a | | Actual FLEX Support ^a | Shortfall in Export Earnings ^a | | Actual FLEX Support ^a |
| | Absolute Value | in % (I Criterion) | Absolute Value | in % (II Criterion) | | Absolute Value | in % (I Criterion) | |
| 30 | Papua N Guinea | | | | | | | |
| 31 | Rwanda | | | | | | | |
| 32 | Sao Tome & P. | | | | | 0,19 | 13,37 | |
| 33 | Samoa | 4,54 | 34,0 | 1,11 | 1,54 | | | |
| 34 | Senegal | | | | | | | |
| 35 | Solomon Islands ^b | | | | | | | |
| 36 | St Lucia | | | | | 0,001 | 13,34 | |
| 37 | St. Kitts & Nevis | 5,06 | 13,9 | 1,66 | 10,53 | 0,40 | 7,10 | 1,78 |
| 38 | St. Vincent/Gren. | 4,68 | 13,3 | 1,42 | 7,37 | 0,35 | | |
| 39 | Sudan | 61,00 | 45,3 | 8,80 | 0,96 | | | |
| 40 | Suriname | | | | | | | |
| 41 | Swaziland | 238,38 | 17,6 | 66,27 | 208,59 | 16,10 | 4,23 | 35,50 |
| 42 | Tanzania | | | | | | 0,04 | 1,18 |
| 43 | Tonga | 6,45 | 49,9 | 1,84 | 111,44 | 0,63 | | |
| 44 | Uganda | | | | | | | |
| 45 | Vanuatu | | | | | | | |
| 46 | Zambia | | | | | | | |
| 47 | Zimbabwe | | | | | | 0,00 | 99,93 |
| | Total | 1067,2 | | 228 | | 53,9 | 148,54 | 24,45 |

Source: Own calculations on data from EU Commission.

(a) Data in EURO mln.

(b) Data of actual FLEX amounts for Guyana and Solomon over the application years 2000 and 2001 are provided as a combined figure. The amounts for 2000 and 2001 are derived for each country after weighting the number provided against the annual share of public deficit in the two year-period.

(c) The main change introduced by the 2004 FLEX revision was the reduction of the impact on public deficit, as a result of exogenous export side shocks, from 10% to 2%. Furthermore, the clause regarding a 2% drop in export earnings was extended to landlocked countries and islands.

(d) The eligibility criterion triggered to the impact on the public deficit was abolished in the 2008 FLEX revision.

5.2 On the Eligibility Criteria

Data reported in Table 2 summarise the working of FLEX. As said above, the total number of shortfalls occurring from 2000 to 2007 was 151, and 123 of them were higher than the fluctuation threshold fixed with the first eligibility criterion. As reported in Table 2, the first eligibility criterion has not been a serious obstacle for ACPs wishing to gain access to FLEX assistance. Indeed, the fulfilment rate of this qualifying condition is high in every year of the period under scrutiny: from 2000 to 2006, the minimum value of the fulfilment rate was 77.8% in 2000, while, in 2002, all 19 shocks satisfied the FLEX constraint. The same applies for 2006 when 16 shocks met the qualifying criterion. In 2007, 4 out of 18 shocks were higher than the imposed threshold. All this evidence widely supports the 2008 ACP-EU decision to maintain 10% (2% for LDCs) as the fluctuation threshold to apply for FLEX support.

With regard to the impact on ACP public deficit caused by drops in exports, it is cogent to distinguish between the different phases which have characterised the FLEX since 2000. It is possible to identify two sub-periods from 2000 to 2006. The first phase regards the application years 2000-2002, where the FLEX operating rules were those established when the facility was first applied. The second phase covers the application years 2003-2006 subsequent to the 2004 FLEX revision. Finally, a new phase started in 2007 with the revision made in 2008.

Table 2 reports the year-by-year number of requests which fulfilled both FLEX eligibility criteria (line C, Table 2) and the budget-admitting rate, determined as the ratio between the number of requests which fulfilled criteria 1 and the number of requests satisfying both eligibility criteria. When this ratio is close to unity then it is possible to argue that the qualifying criterion related to the impact on public deficit does not impede ACP access FLEX support, given a 'sizable' shock on exports side.

As outlined above, at the beginning of the period, an ACP might apply for FLEX support if an exogenous shock resulted in a 10% worsening (2% for LDCs) in public deficit. This threshold greatly restricted the number of ACPs eligible for compensation: the rejection rate was, on average, 75% from 2000 to 2002 (only 10 out of 40 requests satisfied the second criterion, given that the first criterion was fulfilled), with a peak of 84.2% in 2002. This condition was an obstacle for ACPs in their attempts to become eligible for FLEX support and the ACP-EU Council of Ministers intervened

TABLE 2 - ACP States' Export Earnings Instability and FLEX Support over the Period 2000-2007. A Summary.

| | 1 st phase of FLEX | | | | | 2 nd phase of FLEX | | | | | 3 rd phase of FLEX ^b |
|---|--|-------|-------|---------|--------|-------------------------------|--------|--------|---------|-------|--|
| | 2000 | 2001 | 2002 | 2000-02 | 2003 | 2004 | 2005 | 2006 | 2003-06 | 2007 | |
| | Number of ACPs which reported a shortfall of export earnings (A) | 18 | 20 | 19 | 57 | 27 | 19 | 14 | 16 | 76 | 18 |
| Number of requests which fulfilled criterion 1 (B) | 14 | 17 | 19 | 50 | 25 | 16 | 12 | 16 | 69 | 4 | |
| Number of requests which fulfilled criteria 1 and 2 (C) | 3 | 4 | 3 | 10 | 17 | 13 | 11 | 12 | 53 | | |
| Budget-admitting rate (C/B) | 21,4% | 23,5% | 15,8% | 20,0% | 68% | 81,3% | 91,7% | 75% | 76,8% | | |
| Total assistance required (D) (in Euro MLN) | 92,61 | 77,57 | 10,57 | 180,75 | 287,75 | 167,62 | 188,13 | 217,80 | 861,3 | | |
| Number of met requests | 3 | 4 | 1 | 8 | 13 | 8 | 11 | 12 | 44 | 4 | |
| Total assistance available (E) (in Euro MLN) | 19,25 | 12,77 | 3,63 | 35,65 | 81,51 | 10,61 | 50 | 53,89 | 196,01 | 24,45 | |
| Financial coverage (in %) (E/D) | 20,8% | 16,5% | 34,3% | 19,72% | 28,3% | 6,3% | 26,6% | 24,7% | 22,76% | | |
| Number of met requests not disbursed yet | 1 | 1 | 0 | 2 | 6 | 3 | 7 | 12 | 28 | 4 | |
| Total Payments made (in Euro MLN) (F) | 16,09 | 8,60 | 2,16 | 26,8 | 32,26 | 4,15 | 17,85 | 0 | 54,254 | 0 | |
| Payment rate (in %) (F/E) | 84% | 67,3% | 59,5% | 75,3% | 39,6% | 39,2% | 36% | 0% | 27,7% | | |

Source: Own calculations on data from EU Commission.

(a) The main change introduced by the 2004 FLEX revision was the reduction of the impact on public deficit, as a result of exogenous export side shocks, from 10% to 2%. Furthermore, the clause regarding a 2% drop in export earnings was extended to landlocked countries and islands.

(b) The eligibility criterion triggered to the impact on the public deficit was abolished in the 2008 FLEX revision.

twice in this respect: as mentioned above, the threshold was reduced from 10% to 2% in 2004 and removed completely in 2008.

The 2004 FLEX revision introduced the second phase of FLEX (application years 2003-2006) and translated into an increase in the number of requests satisfying the public deficit condition. In fact, during this period there were 69 requests for FLEX support which fulfilled the first qualifying condition and among these 53 requests also met the second eligibility requirement. Thus, from 2003 to 2006, the budget-admitting rate was, on average, 76.84% ($=53/69*100$) and the annual rates were as follows: 68% in 2003, 81.3% in 2004, 91.7% in 2005 and 75% in 2006 (Table 2).

If, on the one hand, the increase in the budget-admitting rate was expected given the 2004 FLEX revision, on the other hand, the EU and the ACPs decided to eliminate the second eligibility criterion in 2008 (some arguments in favour of this removal are discussed above). The new operating rules came into play in the application year 2007.

5.3 Actual FLEX Compensation

This section focuses on FLEX payments made during the period 2000-2007. From 2000 to 2007, the total number of FLEX payments was 56 and their distribution over time reflects:

- (a) the 2004 and 2008 changes in the facility operating rules and
- (b) the increase in financial resources.

In the first three years of the period, there were 10 requests satisfying both eligibility criteria and the corresponding total theoretical assistance was 180.75 million euro (Table 2). Against this, the EU admitted 8 compensation payments with an availability of resources of 35.65 million euro. Thus, the financial coverage in the first phase of FLEX was low (20.8% in 2000, 16.5% in 2002 and 34.4% in 2002). This difference between the potential support and the effective disbursement depended on the availability of resources which were limited according to the amount of funds in the Country B-Envelopes.

In this respect, the facts do not change when the second phase of FLEX (years 2003-2006) is considered. While the total amount of financial assistance determined by those shortfalls in export earnings which were considered eligible for FLEX support was 869,3 million euro, the actual declared transfers amounted to 196,01

million euro. Hence, from 2003 to 2006, the average percentage of financial coverage was 20.73%, that is to say FLEX compensated for slightly more than one fifth of worsening ACP public deficit as a consequence of export shocks. On an yearly basis, the financial resources available totalled 81,51 million euro in 2003, 28,3% of the assistance required that year (287,75 million euro), while, in 2004, the availability of finance was low (10,61 million euro), that is to say 6.3% of the amount theoretically required for support (167,6 million euro). The available resources increased, respectively, to 50 in 2005 and 53,89 million euro in 2006³³, while the requests for compensation amounted to 188 million euro in 2005 and 217 million euro in 2006. This evidence indicates that relaxing the qualifying criteria increased the frequency of eligible requests, but the amount of finance was still too low to give ACPs adequate assistance, despite the significant increase of financial resources in 2005 and 2006.

With regard to 2007, data on the theoretical amount of FLEX support determined by 2008 FLEX revision are not available country-by-country, but the 4 ACP countries (Burundi, Ivory Coast, Guinea Bissau, St Kitts/Grenadines, see Table 1) admitted for FLEX support receive 24,52 million euro in assistance, a value of resources which is significantly lower than that (80-100 million euro) available as a maximum annual FLEX allocation for all ACP countries.

When analysing payments at individual country level, it emerges that there were 28 beneficiaries. 10 of these³⁴ received financial assistance in 3 out of 8 years, 8 ACPs benefited from FLEX support for 2 years³⁵, while 10 ACPs received only one payment³⁶ (Table 1).

The distribution of transfers by country is quite concentrated. The Ivory Coast has been the major beneficiary of FLEX, with

³³ Data include the 3,99 million euro allocated among 10 ACP countries (Benin, Comoros, Ivory Coast, Dominica, Madagascar, Mauritius, St. Kitts and Nevis, St. Vincent/Grenadines, Swaziland and Tonga) to top up their FLEX amounts for the application year 2006 by increasing the existing B-envelope allocation. This topping up results from differences between initial allocations based on provisional export data and corrected allocation based on final export data (European Commission, 2009).

³⁴ Burundi, Comoros, Dominica, Guinea-Bissau, Guyana, Ivory Coast, Malawi, Mauritania, Mauritius and St. Lucia.

³⁵ Benin, Central African Republic, Grenada, Madagascar, Samoa, St. Vincent/Gren., Solomon Islands and St. Kitts and Nevis.

³⁶ Botswana, Fiji, Gambia, Jamaica, Mali, Papua New Guinea, Swaziland, Tonga, Vanuatu and Zambia.

42,54 million euro in financial support (16.61% of the total). The top five beneficiaries (Ivory Coast, Mauritius, Mauritania, Papua New Guinea and Swaziland) accounted for more than 50% of the total. At the opposite end of the scale, there are 10 ACPs (Grenada, St. Kitts and Nevis, Fiji, Samoa, Jamaica, Gambia, Vanuatu, Comoros, Mali, Tonga and) which individually received less than 1% and which, together, account for less than 7% of total FLEX transfers. Table 3 also presents the amount of FLEX support *pro capita* and the GDP *pro capita*, both expressed as geometric averages over the 1998-2007 period. It emerges that, in relative terms, the major five beneficiaries of FLEX were Dominica (81 euro *pro capita*), St. Vincent (44.4), Saint Lucia (33.4), Mauritius (26.2) and Grenada (22.9), which, in the distribution of GDP *pro capita* (column 5), are above the average level of GDP *pro capita* for FLEX beneficiaries. Another point of interest is the fact that the correlation between FLEX *pro capita* (column 4) and GDP *pro capita* (column 5) is 0.6 (Table 3).

5.4 The Date of FLEX Disbursements

Some final considerations can be made by looking at payments made by the EU in favour of ACPs and the dates of these disbursements. Table 4 presents the payments by individual country, a summary of which is reported in the last three rows of Table 2. Three key results emerge from the data.

The first finding refers to the time-lag between the shortfall year and the period when the payment is made. In fact, it takes, on average, about 4 years to make a payment: the first FLEX payment was made in 2004 to provide additional support for Zambia's worsening public deficit due to an export shock registered in 2000. In 2005, Guyana received support for shocks experienced in 2000 and 2001. This delay in payment also regards more recent application years. No disbursement has yet been made for the application year 2006, while, during the first months of 2009, the EU disbursed 4 out of 11 requests of additional support for losses experienced in 2005.

This time-lag is similar to that associated to the other two main compensatory financing facilities (the CFF of the IMF and the EU's STABEX). Indeed, the time-lag for disbursements was, on average, about 4 years (Aiello, 1999a and 1999b; Lim, 1991, Herrmann *et al.*, 1993) during the period when these two facilities were intensively used by eligible countries. While the delay in FLEX payments is not

TABLE 3 - *FLEX Support by Country over the Period 2000-2007*

| | Country | Absolute Values (data in Mln of Euro) (1) | % (2) | % Cum. (3) | FLEX/POP (Euro per capita)* (4) | GDP per capita (Euro per capita)** (5) |
|----------------------|-------------------|---|-------|------------|---------------------------------|--|
| 1 | Ivory Coast | 42,54 | 16,61 | 16,61 | 2,40 | 1506 |
| 2 | Mauritius | 32,60 | 12,73 | 29,34 | 26,62 | 8480 |
| 3 | Mauritania | 22,46 | 8,77 | 38,11 | 8,24 | 1546 |
| 4 | Papua New Guinea | 22,44 | 8,76 | 46,87 | 4,02 | 1618 |
| 5 | Swaziland | 16,10 | 6,29 | 53,16 | 16,02 | 4162 |
| 6 | Guyana | 14,53 | 5,67 | 58,83 | 19,30 | 2923 |
| 7 | Malawi | 12,82 | 5,01 | 63,84 | 1,03 | 595 |
| 8 | Zambia | 11,49 | 4,49 | 68,32 | 1,03 | 1003 |
| 9 | Madagascar | 8,84 | 3,45 | 71,77 | 0,49 | 763 |
| 10 | Botswana | 8,06 | 3,15 | 74,92 | 5,10 | 11540 |
| 11 | Solomon Islands | 7,25 | 2,83 | 77,75 | 15,71 | 1456 |
| 12 | Burundi | 6,71 | 2,62 | 80,37 | 0,93 | 305 |
| 13 | Benin (PMA) | 6,65 | 2,60 | 82,97 | 0,94 | 1248 |
| 14 | Dominica | 5,89 | 2,30 | 85,27 | 81,81 | 7346 |
| 15 | St Lucia | 5,38 | 2,10 | 87,37 | 33,22 | 11008 |
| 16 | Central Afr. Rep. | 5,32 | 2,08 | 89,45 | 1,34 | 610 |
| 17 | Guinea-Bissau | 4,93 | 1,92 | 91,37 | 3,26 | 431 |
| 18 | St. Vincent/Gren. | 4,75 | 1,85 | 93,23 | 44,60 | 6749 |
| 19 | Grenada | 2,37 | 0,93 | 94,15 | 22,88 | 8399 |
| 20 | St. Kitts & Nevis | 2,18 | 0,85 | 95,00 | 45,13 | 8054 |
| 21 | Fiji | 2,10 | 0,82 | 95,82 | 2,49 | 3519 |
| 22 | Samoa | 2,08 | 0,81 | 96,63 | 11,59 | 4163 |
| 23 | Jamaica | 2,00 | 0,78 | 97,42 | 0,76 | 6190 |
| 24 | Gambia | 1,80 | 0,70 | 98,12 | 1,24 | 1015 |
| 25 | Vanuatu | 1,70 | 0,66 | 98,78 | 8,13 | 3102 |
| 26 | Comoros | 1,38 | 0,54 | 99,32 | 2,32 | 974 |
| 27 | Mali | 1,11 | 0,43 | 99,75 | 0,09 | 806 |
| 28 | Tonga | 0,63 | 0,25 | 100,00 | 6,21 | 4296 |
| Total FLEX transfers | | 256,11 | | | | |

Source: See table 1.

Data in columns 4 and 5 are expressed as geometric average over the period 2000-2007.

*Data on population and GPD (in PPP) are from IMF, World Economic Outlook, October 2008.

easy to understand given the massive use of modern technology and numerous improvements in bureaucracy, it ought to be remembered that the fact that (a) FLEX only became operational in 2003, with the application of the Cotonou Agreement and of the 9th EDF, and (b) the decision to assign 50 million euro to the application years 2005 and 2006 dated from 2007, once guarantees were obtained on the availability of funds. With the current FLEX some improvements in respect to the speed of support are expected. Indeed, the extension of advance payments to 100%, for ACPs eligible for budgetary support, (see § 1.3.2) should also have an impact with regard to the attempt to guarantee rapid disbursements. Indeed the fact that, already at the time of writing, requests relative to application year 2007 have been processed and resources have been committed (Table 1) is a positive initial signal in this direction.

The second result is that many of the declared payments have not actually been made yet. 34 of the 56 accepted requests are still unpaid. In particular, 3 requests of 2003 still wait for support and many others (for instance, 7 for 2005 and 12 for 2006) have experienced a significant delay of 3-4 years. There are even 2 requests for 2000-2001 and 6 for 2003 which are still to be disbursed (Tables 2 and 4).

The conclusion is that the total value of FLEX payments effectively made from 2000 to 2007 is just a limited proportion of the amount that the EU Commission decided to contribute in the form of support. This ratio between the requests for assistance which were accepted and the payments effectively made is clearly high when the early years of FLEX are considered (84% in 2000, 67,3% in 2001 and 59,5% in 2002). On the other hand, it stands at less than 40% when considering the application years 2003-2005. In brief, the total amount effectively paid since 2000 is 81 million euro, i.e. about 32% of the total amount (246,11 million euro) which the EU accepted should be disbursed (Tables 2 and 4).

6. DISCUSSION AND LESSONS LEARNT

The evaluation of FLEX may be made by comparing its actual workings with that which one would expect of an ideal effective facility. Given an export shortfall caused by an exogenous shock, it is reasonable to argue that FLEX can be considered effective when it provides rapid disbursements whose size is enough to allow ACP states to pursue the objectives as they are established in the ACP-

Table 4 (continued)

| Countries | Application Year 2000 | | | | Application Year 2001 | | | | Application Year 2002 | | | | Application Year 2003 | | | |
|----------------------|--------------------------|---------------------|------------------------|----------------------|--------------------------|---------------------|------------------------|----------------------|--------------------------|---------------------|------------------------|----------------------|--------------------------|---------------------|------------------------|----------------------|
| | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement |
| 15 Malawi | | | | | | | | | 8,76 | 8,76 | 8,76 | 2007 | | | | |
| 16 Mali | | | | | | | | | | | | | | | | |
| 17 Mauritania | | | | | 3,63 | 3,63 | 2,16 | 2007 | 19,79 | 17,97 | 6,456 | 2007/8 | | | | |
| 18 Mauritius | | | | | | | | | | | | | | | | |
| 19 Papua N.G. | | | | | | | | | 22,44 | 22,40 | | NP | | | | |
| 20 Samoa | | | | | | | | | 0,94 | 0,94 | | NP | | | | |
| 21 Solomon Islands | 13,42 | 3,13 | | NP | 17,65 | 4,12 | | NP | | | | | 1,68 | 1,68 | | NP |
| 22 St Lucia | | | | | | | | | | | | | | | | |
| 23 St. Kitts & Nevis | | | | | | | | | | | | | | | | |
| 24 St.Vincent/Gren. | | | | | | | | | 4,40 | 4,40 | | | | | | NP |
| 25 Swaziland | | | | | | | | | | | | | | | | |
| 26 Tonga | | | | | | | | | | | | | | | | |
| 27 Vanuatu | | | | | 1,70 | 1,70 | 1,62 | 2005/7 | | | | | | | | |
| 28 Zambia | 11,49 | 11,49 | 11,49 | 2004 | | | | | | | | | | | | |
| Total | 92,61 | 19,22 | 16,09 | | 77,57 | 12,80 | 8,60 | | 3,63 | 3,63 | 2,16 | | 246 | 81,5 | 32,255 | |

Table 4 (continued)

| Countries | | Application Year 2004 | | | | Application Year 2005 | | | | Application Year 2006 | | | |
|-----------|-------------------|--------------------------|---------------------|------------------------|----------------------|--------------------------|---------------------|------------------------|----------------------|--------------------------|---------------------|------------------------|----------------------|
| | | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement | Impact on public deficit | Actual Flex support | Effective Flex Payment | Year of disbursement |
| 1 | Benin (PMA) | | | | | 5,38 | 1,43 | 1,43 | 2009 | 16,75 | 5,22 | | NP |
| 2 | Botswana | | | | | | | | | | | | |
| 3 | Burundi | | | | | | | | | | | | |
| 4 | Central Afr. Rep. | | | | | 3,48 | 0,92 | 0,92 | 2009 | | | | |
| 5 | Comoros | 0,38 | | 0,36 | 2009 | 1,92 | 0,51 | | NP | 2,01 | 0,49 | | NP |
| 6 | Ivory Coast | | | | | 43,21 | 11,48 | | NP | 45,13 | 10,97 | | NP |
| 7 | Dominica | | | | | 3,85 | 1,03 | | NP | 1,85 | 0,48 | | NP |
| 8 | Fiji | 12,06 | 2,10 | | NP | | | | | | | | |
| 9 | Gambia | | | | | | | | | | | | |
| 10 | Grenada | | | | | 6,43 | 1,71 | | NP | 3,16 | 0,66 | | NP |
| 11 | Guinea-Bissau | 1,20 | 1,20 | 1,20 | 2007 | | | | | | | | |
| 12 | Guyana | | | | | 23,07 | 6,13 | | NP | | | | |
| 13 | Jamaica | | | | | | | | | | | | |
| 14 | Madagascar | | | | | 21,52 | 5,72 | 5,72 | 2009 | 12,87 | 3,12 | | NP |
| 15 | Malawi | 20,27 | 1,24 | 1,24 | 2007 | | | | | 12,30 | 2,82 | | NP |
| 16 | Mali | 11,50 | 1,11 | 1,11 | 2006 | | | | | | | | |
| 17 | Mauritania | | | | | 3,24 | 0,86 | | NP | | | | |
| 18 | Mauritius | 44,27 | 0,44 | | NP | 73,40 | 19,51 | 9,78 | 2009 | 52,54 | 12,65 | | NP |
| 19 | Papua N.G. | | | | | | | | | | | | |
| 20 | Samoa | 1,14 | 1,14 | 0,243 | 2008 | | | | | | | | |
| 21 | Solomon Islands | | | | | | | | | | | | |
| 22 | St Lucia | 3,00 | 3,00 | | NP | 2,63 | 0,70 | | NP | | | | |
| 23 | St. Kitts & Nevis | | | | | | | | | 1,66 | 0,40 | | NP |
| 24 | St.Vincent/ Gren. | | | | | | | | | 1,42 | 0,35 | | NP |
| 25 | Swaziland | | | | | | | | | 66,27 | 16,10 | | NP |
| 26 | Tonga | | | | | | | | | 1,84 | 0,63 | | NP |
| 27 | Vanuatu | | | | | | | | | | | | |
| 28 | Zambia | | | | | | | | | | | | |
| | Total | 186,59 | 10,61 | 4,15 | | 188,13 | 50 | 17,85 | | 217,80 | 53,89 | | |

Source: Own calculations on data from EU Commission.

Note: NP = no payments yet.

EU agreement³⁷. Timely financing ensures that the scheme will be countercyclical and not pro-cyclical.

In the past, the FLEX facility suffered from some constraints that greatly limited its impact. Despite FLEX only having been introduced in 2000, the ACPs-EU has paid a great deal of attention to simplifying the criteria that ACPs must meet to be eligible for support. As highlighted above, the changes in FLEX operating rules have resulted, as expected, in increasing the number of requests 'admitted' for consideration for budgetary support. However, the ultimate aim of FLEX is not to increase the numbers of countries eligible for support, but to provide quick sizable payments intended to

“safeguard socio-economic reforms and policies that could be affected negatively as a result of a drop in revenue and to remedy the adverse effects of instability of export earnings, in particular from agricultural and mining products” [Article 68(2) of the 2005 revised Cotonou Agreement].

The main lesson to be learnt from the experience of FLEX over the period 2000-2007 is that this facility failed to achieve its objective mainly because of: (a) lack of finance to be allocated to ACPs ; (b) delays in financing.

The limited resources need further urgent attention for two reasons. First, FLEX is an important financing facility which many commodity dependent developing countries refer to when they experience a temporary exogenous shock in export earnings (as reported above, the other active facility dealing with export side shocks, the CFF of the IMF, has not been used since 2000)³⁸. Second, it would seem pointless to maintain a facility and work hard to guarantee that it functions well if, at the end of the selection process, the countries admitted did not receive any support because of the lack of finance. From the experience of FLEX since 2000 and looking at the total yearly assistance required by ACPs over the

³⁷ *“The purpose of support in cases of short term fluctuations in export earnings is to safeguard socio-economic reforms and policies that could be affected negatively as a result of a drop in revenue and to remedy the adverse effects of instability of export earnings, in particular from agricultural and mining products”* [Article 68(2) of the 2005 revised Cotonou Agreement].

³⁸ It is worth noticing that the justification for the existence of FLEX ought to take into account not only the circumstances that ACPs refer to when they suffer from export shocks, but also the opportunity costs involved in maintaining the facility and the real needs it addresses.

period 2000-2006 (see Table 2), it is reasonable to argue that the recommendation to address the issue of finance holds true despite the efforts made to raise the B-envelope to EUR 50 million for the application years 2005 and 2006. However, data for the application year 2007 indicate that the demand for assistance is less than the finance (EUR 80-100 MLN) available as an annual FLEX-Envelope.

With regard to the second lesson from FLEX, that of its time delay in providing financial support, it is unquestionable that this is largely due to the fact that the facility operates on the basis of an *ex-post* rather than a *real time* mechanism. By referring to actual export earnings, FLEX incurs the delay associated with data recording, a process which takes a great deal of time. This holds true whatever the efforts of the EU Commission to collect, elaborate and validate export earnings data.

An alternative to a receipts-based trigger scheme might be a mechanism that uses prices as a valuable variable to anticipate the impact of a shock. This idea will be the object of investigation by many scholars and organizations. The advantage in using commodity prices is that they are available on a monthly basis and are disseminated by international organisations, i.e., they are beyond the control of any individual country. The limit to using prices is that they disregard losses in earnings due to exogenous shocks affecting the volume traded. However, this caveat may be overcome by having a significant amount of financial support triggered by *ex-ante* prices and the remaining refunded by *ex-post* export earnings.

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ABSTRACT

This paper describes some policy instruments set up by the IMF and the European Union in order to provide financial assistance to developing countries whose economies are affected by exogenous shocks from exports side. After briefly reviewing the IMF's CFF and the EU's STABEX, the paper presents the operational rules of FLEX and comments on how it functioned from 2000 to 2007. The analysis shows that the FLEX facility suffered from there being inadequate finance allocated to ACPs and from delays in the financing procedure. While these constraints greatly limited the impact of FLEX in the application years 2000-2006, the 2008 FLEX revision eased them and, now, FLEX can guarantee financial support more rapidly than in the past and may more satisfactorily cover the financial requirements of ACPs coping with export earnings instability.

Keywords: Budget Support, Developing Countries, Export Earnings Instability

JEL Classification: F35, O19

RIASSUNTO

Esperienze dei tradizionali sistemi di compensazione finanziaria e lezioni dal caso FLEX

In questo saggio si confrontano alcuni strumenti di politica economica introdotti dal FMI e dall'UE per garantire assistenza finanziaria ai PVS che sono penalizzati dall'instabilità delle loro esportazioni. Dopo aver brevemente presentato il sistema di compensazione finanziaria (CFF) del FMI e lo schema STABEX dell'UE, l'articolo dapprima discute del meccanismo di funzionamento del FLEX e successivamente ne presenta una valutazione empirica per il periodo 2000-2007. L'analisi mostra l'esistenza di due principali vincoli del sistema FLEX. Il primo riguarda l'insufficienza delle risorse finanziarie rispetto alla domanda di assistenza proveniente dai paesi ACP, mentre il secondo vincolo è rappresentato dai ritardi con cui l'UE effettua i pagamenti. Se da un lato questi vincoli hanno fortemente condizionato l'efficacia del FLEX nel periodo 2000-2006, dall'altro lato le modifiche introdotte nel 2008 hanno migliorato e snellito il meccanismo di funzionamento del sistema. Pertanto, l'attuale FLEX può garantire assistenza finanziaria in modo più rapido rispetto al passato e può offrire una copertura finanziaria che è adeguata per far fronte agli effetti determinati dalle inattese riduzioni di breve periodo dei ricavi delle esportazioni dei paesi ACP.

