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How to Allocate New External Financing to African Countries ? *The vulnerability challenge*

A Briefing in Response to the Paris Summit on Financing African Economies*

Patrick Guillaumont, Sylviane Guillaumont-Jeanneney, Laurent Wagner

Patrick Guillaumont, President of FERDI.

Sylviane Guillaumont Jeanneney, Advisor at FERDI, Emeritus Professor at the Université d'Auvergne, former Director of CERDI.

Laurent Wagner, PhD in Economics, Research Officer at Ferdi.

If it becomes possible to mobilize significant external financing for Africa, it is necessary to consider how these flows will be distributed among the various African countries. The issues facing the Summit are both Africa's financing needs compared to those of regions and the respective needs of the various African countries. Not all of these countries have the same needs or the same absorptive capacity.

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The very reasons for increasing Africa's external financing are also reasons for considering its allocation among African countries. It seems easy to agree on the principle that any financial distribution of aid to African countries should contribute to pursuing the Sustainable Development Goals. However, there must be agreement on some synthetic and priority objectives which speak to public opinion (reducing poverty in its various dimensions, adapting to global warming and protecting environment and security in all its forms, etc.).

There are two categories of public flows to be mobilized and distributed: those designed to target short-term needs, in order to deal quickly with a shock such as the Covid 19 crisis, and those supporting the medium and long-term development of African countries. The distribution of short-term assistance , which in the case of Covid 19 has already been partly mobilized, is conditioned by the size of the immediate shocks suffered by the individual countries, while the distribution of development funding must be based on a consensus on medium- and long-term financing needs. This note is essentially devoted to the latter.

Depending on the nature of the financing available for development, its allocation to the various African countries is handled differently. Only the allocation of public flows, especially concessional flows, depends on government decisions, which are taken bilaterally or through international development institutions. Indeed, each public entity that finances Africa has its own rules and applies its own allocation criteria. However, to avoid the overall risk of inequitable allocation among the different countries, it would be useful for the international community to *agree on some allocation principles*, which for bilateral donors would only be a recommendation, applied by all parties as they see fit, but which could be applied more directly by multilateral development institutions. *The criteria for the allocation of concessional funds by multilateral institutions operating in Africa are a crucial issue and should be agreed upon by international consensus*. The allocation principles recommended to bilateral donors, could be reflected in a degree of (geographical) selectivity based on similar criteria; a regular publication of this measure would serve as an incentive. In both cases, the ex ante allocation criteria and the ex post selectivity criteria, a consensus should be needed.

Moreover, two other public decisions will affect how external funds are distributed among countries. The first relates to the debt treatment, the benefits of which may be unevenly distributed among countries. The second is the allocation of possible special drawing rights (SDRs), particularly in the event that the countries with the highest quotas decide to reallocate some of their new SDRs to low-income, low-quota countries. This issue, as will be seen, cannot be addressed without taking into account the IMF rules for credit to poor countries.

To frame the debate, let us recall a few figures that give the order of magnitude of the annual volume of contributions to African countries south of the Sahara either as ODA or though debt arrangements or possible SDR emissions.

According to OECD statistics, concessional payments (ODA) to South Africa in the Sahara amounted to US$52.6 billion in 2019, including US$25.6 billion in multilateral funding and US 25.4 in bilateral public funding from DAC countries.

Other public funding (plus private donations) was simultaneously US$16.6 billion, of which US$2.2 was from multilaterals and US$14.3 billion from bilaterals.

Debt adjustments for African countries by the G20 countries, in the form of a postponement of maturities for the period between May 2020 and June 2021 (the so-called Debt Sustainability Suspension Initiative, DSSI) amounted to a contribution of US $10.1 billion for the period.

As for the share that would fall to African countries in the case of an SDR issue, it would vary greatly according to the modalities used (see calculations made at CGDev by Daouda Sembene, 2021). In the case of a $500 billion issue, direct allocation under quotas would go to Africa south of the Sahara for 18.1 billion dollars (25.6 for all of Africa, 5.1 for low-income countries alone) and a reallocation by the G7 countries to African countries of 10% of the 217 billion emissions allocated to them according to quotas would amount to $21.7 billion.

Promoting a consensus on criteria, including structural vulnerability for the allocation of multilateral development assistance to Africa, as well as on criteria for the selectivity of the bilateral one

The issue of the allocation of concessional funds is addressed in international institutions, particularly in multilateral development banks, and in particular at the African Development Bank (AfDB) for the allocation of ADF funds among African countries. It involves a trade-off between performance and needs criteria, the main difficulty being that the most fragile (and most in need) countries are also those considered to be the worst performers. To overcome this difficulty, some states have been arbitrarily categorized as so-called fragile (transition) states, to which specific funding is then allocated. However, this categorization does not take into account the varying degrees of fragility or vulnerability among countries and may unfairly overlook other countries which are also to some extent fragile and which may need specific funding.

A simple and coherent solution would be to *use structural vulnerability as a criterion for allocating concessional funds, structural vulnerability being designed as exogenous with respect to present policy*. Such a strategy could avoid resorting to an always questionable category of fragile countries, and would not lead to any renouncement of the traditional criteria of performance (or governance) criteria and per capita income.[1]

A country's vulnerability is generally designed by the risk that it will be affected by exogenous shocks, either external or natural. These could be economic shocks, climate change shocks or shocks related to political fragility. A country's structural vulnerability results from the size and recurrence of these shocks, as well as from the potential impact they may have on the country due to its economic and social structure. African countries are particularly sensitive to shocks, due to the instability of external demand and the international price of commodities, due to natural disasters such as cyclones or droughts, which drastically reduce agricultural production, and due to violence and conflict. Structurally, the economic vulnerability and the political fragility of African countries remain great. Climate change, for which African countries are not responsible, risks exacerbating the consequences of this political fragility. As has been shown in the case of the Least Developed Countries (LDCs), the structural vulnerability associated with a weakness of human capital generates a vicious circle where shocks have not only an immediate impact, but also lower the capacity to tackle future shocks.[2] The structural and multidimensional vulnerability (economic, climatic and societal) of African countries while differing from country to country, endangers both their domestic policies and the financial support of the international community.

The inclusion of structural vulnerability in the funding allocation criteria has been discussed for the African Development Fund, although a reform has not yet been achieved. Replacing this issue within the overall framework of the Summit on financing African economies should help to advance, not only the reform of the ADF's allocation criteria, but more fundamentally, the idea that it has become essential to preventatively help African countries to face the various vulnerabilities they face, knowing that, in varying forms and to various degrees, all

1. The following arguments have been developed in several works of the authors (see Guillaumont et al., 2017 & 2021).

2. Cf Guillaumont P. (2009,2019)

are vulnerable to exogenous shocks. This would involve moving from the so-called "Performance Based Allocation" (PBA) to a Performance and Vulnerability Based Allocation (PVBA). The same principle should guide the ex-post analysis of the selectivity of different donors to judge the quality of their aid allocation according to both the governance and income per capita of recipient countries and to their structural vulnerability.

In a 2012 resolution on the graduation of Least Developed Countries, the United Nations General Assembly (A/RES/67/221, 21 December 2012) invited development partners to use the following three criteria for identifying LDCs and allocating development assistance: per capita income, low level of human capital and (structural) economic vulnerability. This was done by the European Union in 2014, using the same criteria and adding a governance criterion to define the allocation criteria of the European Development Fund, which largely concerned African countries, and for the Development Cooperation Instrument (which only partially concerned them).[3]

A fair, effective and transparent principle

Taking into account the structural vulnerability of African countries in the allocation of aid is a fair, effective, and transparent principle. It is fair because structural vulnerability in its various forms is a handicap to the sustainable development of African countries and international justice aims to equalize opportunities between countries. It is also effective, as research over the past two decades has shown that aid has greater marginal effectiveness in situations of vulnerability, since it helps cushion shocks[4]. Finally, implementing this principle is a means of improving the transparency of the allocation rules of multilateral institutions, where the need to combine performance research with the response to the needs of the most fragile countries has led to developing exceptions to the basic rule of performance-based allocation, making it opaque in practice[5]. Taking structural vulnerability into account alongside performance, in a logical and simple framework would make it possible to better mark the consistent place of performance.

Two challenges: Assessing structural vulnerability and protecting losers

Assuming that agreeing to the principle that structural vulnerability (alongside with per capita income level) would legitimate an increase of the total amount of aid to Africa and lead to a more appropriate allocation of aid among African countries, two practical objections must be addressed.

The first is the challenge of establishing indicators of vulnerability to use as criteria for allocating multilateral aid and assessing geographic selectivity of bilateral aid. It ought to be possible to promote a consensus on indicators, provided that their purpose, method and relevance are well defined and agreed upon: only the vulnerability that is exogenous with respect to the present policy of countries must be taken into account. While the present structures, as well as per capita income, have been heavily influenced by past policies, present governments can only be held accountable for their present policy, which is currently assessed in the performance indicators used in allocation formulas. Taking into account vulnerability in the allocation prevents populations of countries with high fragility and weak governance from being penalized

3. European Commission, Directorate-General for Development and Cooperation — Europe Aid, European External Action Service, A Methodology for country allocations: European Development Fund and Development Cooperation Instrument 2014-2020. https://ec.europa.eu/internationalpartnerships/system/files/methodology_for_country_allocations_european_development_fund_and_development_cooperation_instrument_2014_2020_en.pdf

4. See Guillaumont and Wagner, 2014, for a summary

5. See Guillaumont and Wagner, 2015

twice, by both governance and allocation.

It is also necessary that the exogenous vulnerability be captured in *its various dimensions, economic, climatic, socio-political*. It should be noted that in a December 2020 Resolution, the United Nations General Assembly expressed the value of such a multidimensional indicator of vulnerability for small island developing states and called for appropriate work to be carried out on how it can be designed and measured[6]. This holds as much for African countries as it does for small island states. Such a work is under way, including at the Commonwealth Secretariat, where it is called the "Universal Vulnerability Index". It is based on numerous studies in this area, in particular at Ferdi, precisely with the aim of defining a relevant allocation criterion.

The second difficulty with a reform of the allocation rules is that it may seem too politically difficult to apply under a constant funding allotment: if it increases the share of some countries, it decreases that of others. The mobilization of additional financial resources for Africa should make a reform of allocation politically easier, so that the resulting decrease in the relative share for some countries could occur without an absolute decrease or with a mitigated decrease.

Let us add that the possible reform of the allocation rules (between African countries) must be placed in a broader context, including both the modalities of debt treatment, the allocation of a possible issuance of SDR and the allocation of IMF credits.

The consequences of debt adjustment in terms of allocation

With regard to debt management, it's important to distinguish between the adjustment measures taken under the G20 following the Covid crisis, which consist of a "debt service suspension initiative" (DSSI) for bilateral debt, and possible relief measures such as those taken in the past with the HIPC and MDRI initiatives.

The distribution of the benefits obtained by countries under debt treatment initiatives depends on the amount of debt accumulated and the difficulties faced by countries. It does not meet the criteria that are or should be retained for the distribution of ODA, namely governance, per capita income and vulnerability level. Indeed, the countries for which debt treatment has been necessary tend to be middle-income countries that sometimes implement weak policies, rather than low-income, high structurally vulnerable, or good-governance countries. If this distribution (expressed as a percentage of the population or overall income) is regressed on those factors, per capita income appears with a positive (rather than negative) sign and the composite indicator of structural vulnerability does not appear to be significant. Such a distribution can nevertheless be justified in response to an emergency (and it has only been a moratorium).

On the other hand, if these were relief or cancellation measures, which would correspond to medium-term development assistance, the distribution of the resulting benefits for individual countries should be assessed according to principles similar to those intended to be applied to ODA. It should be noted that some institutions, such as the African Development Bank, have in the past taken into account multilateral debt arrangements for their own concessional allocation of funds, but nothing like this exists on a global scale. To put in place such a global process, all lending multilateral institutions involved would have to take into account debt relief when determining the funding allocated to each country. Furthermore, debt relief should also be taken into account for the ex post assessment of the geographical selectivity of bilaterals.

If there was a global agreement on an opti-

6. Paragraph 8(a) of Resolution A/RES/75/215, calls on the UN Secretary-General:"(a) To provide recommendations as part of his report on the present resolution to the General Assembly at its 76th session on the potential development and coordination of work within the UN system on a multidimensional vulnerability index for small island developing States, including on its potential finalization and use;» https://undocs.org/en/A/RES/75/215

mal distribution of concessional flows between African countries, it would make sense that the impact of debt relief be included, i.e. that reliefs be deducted from the "optimal distribution" amounts to determine what the allocation of new flows should be.

The allocative consequences of SDR emissions

Let us now consider how a possible allocation of special drawing rights can be made consistent with the general allocation principles outlined above. Since SDRs are allocated on the basis of quotas, it is clear that their allocation under this rule does not correspond to the relative needs of the poorest and most vulnerable countries. However, if countries with high quotas, such as those in the G7 or G20, come to re-allocate all or part of their new SDRs to developing or African countries alone, the question of a fair, effective and transparent distribution arises (as with other development flows). If this reallocation were to be made again on the basis of quotas, the gains obtained by each African country would not be distributed according to the needs resulting from poverty or vulnerability. If, on the contrary, it were agreed to allocate these SDRs on the basis of specific criteria, these could be the very criteria considered for the allocation of ODA, in particular the structural vulnerability of countries, as explained above, rather than criteria corresponding to the current external shocks faced by individual countries as a result of the pandemic and the accompanying global recession.

Thus, it is necessary to agree on the short versus long-term objective of a new SDR allocation. Indeed the exceptional economic shocks faced by African countries as a result of the pandemic and the accompanying global recession has highlighted specific needs. But the allocation of SDRs should be aimed at mitigating medium- and long-term impact of potential future shocks, i.e. at building resilience to them. This is why it should be an allocation based on criteria similar to those recommended for allocating development assistance, and therefore taking into account exogenous vulnerability.

A related issue is whether the SDRs will be reallocated by each country (of the G7) according to its own criteria or according to common rules. If they are reallocated according to common rules (which is desirable), reallocated SDRs should be brought together in a common fund. This raises the question of the choice of the institution in charge of the reallocation of these new SDRs and the financial conditions of their use. There are a number of options, including the creation of a specific multilateral fund, an increase of IDA (or possibly ADF) resources, or, perhaps most naturally, of the IMF's Poverty Reduction and Growth Trust (PRGT). This option, however, raises the issue of the ceiling on IMF contributions set for each country; to solve this problem, a revision of the rules that currently set these ceilings according to quotas would be required and should then take into account the exogenous vulnerability of countries.[7] As for the option of switching through the IDA or the ADF, this would reinforce the long-term development support of the reallocation of SDRs, but it would be better justified if the institution concerned were invited by its shareholders to move from a "performance based allocation" to a "performance and vulnerability based allocation", as suggested above.

Moreover, the choice of the institution responsible for the management of reallocated SDRs will not be without consequence on the terms of their use (financial conditions, allocation and conditionality).

7. or a revision of the quotas themselves, which today seems unrealistic.

Remarks in conclusion

Through the review of the allocation of three sources of external public financing to African countries (ODA, debt management and SDR emissions), it seemed appropriate to promote the idea that structural vulnerability should be taken into account for the distribution among countries, alongside the traditional criteria of per capita income and performance. This would not lead to giving less attention to performance, but rather to re-examining its meaning, which should take into account countries' efforts to reduce their vulnerability and increase their resilience to external shocks.

The willingness of development partners of African countries to address their vulnerability is of common interest. Indeed, the consequences of the shocks suffered by African countries not only undermine their sustainable development, but also threaten other countries, especially those of Europe.

The coherence between the allocation of the various sources of concessional financing for African countries, whose common interest reinforces the need, implies at least a coordination between them, based on an international consensus. Since the geographical distribution of bilateral and regional public contributions cannot be freed from specific objectives, the question arises as to how the multilateral system can ensure overall consistency.

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Contact
www.ferdi.fr
contact@ferdi.fr
+33 (0)4 73 17 75 30

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