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

A note prepared in view of the Paris Summit on Financing African Economies*

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



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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 this distribution should contribute to pursue the sustainable development goals. However, there must be an agreement on a few 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.).

However, there are two categories of public flows to be mobilized and distributed, those corresponding to short-term needs, in order to deal quickly with a shock such as the one resulting from Covid 19, and those supporting the medium and long-term development of African countries. The distribution of the former, which in the case of Covid 19 has already been partly mobilized, is in fact conditioned by the size of the immediate shocks suffered by the countries, while the distribution of the latter 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, the question of their allocation between African countries arises differently. Only the allocation of public flows, especially concessional flows, depends on government decisions, taken bilaterally or through international development institutions. Indeed each public entity financing Africa has its own rules and applies its own allocation criteria. But to avoid too much risk of unequal overall allocation, it would be useful *to agree on a few allocation principles*, which for bilateral donors would only be a course of action, applied by everyone in their own way, 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 at the heart of the problem and should be an expression of international consensus.* As for the allocation principles that would be recommended to bilateral donors, they could express themselves

into a degree of selectivity (geographical) that would be based on similar criteria; regular publication of this measure would serve as an incentive. In both cases a consensus should be sought.

Moreover, two other public decisions will affect the distribution of external funds between 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 re-allocate some of them 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 giving the order of magnitude of the annual volume of contributions to African countries south of the Sahara under ODA, debt arrangements and 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 25.4 in bilateral public funding from DAC countries.

Other public funding (plus private donations) was simultaneously \$16.6 billion, of which \$2.2 was from multilaterals and \$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 \$10.1 billion for the period.

As for the share that would fall to African countries in the case of an SDR issue, it varies greatly according to the modalities that would be 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 (SSA or all of Africa) 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 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. This treatment involves a trade-off between performance and needs criteria, the main difficulty coming from that the most fragile countries (and the most in need) are also the countries considered to be the worst performers. To overcome this difficulty, a category of so-called fragile (or transition) states has been arbitrarily used, to which a specific envelope is allocated. However, this does not allow us to take into account the different degrees of fragility or vulnerability between countries that are said to be fragile and benefit from the envelope, nor between other countries which are also fragile to some extent.

A simple and coherent solution is *to have the structural vulnerability of countries recognized as a criterion for allocating concessional funds to African countries, their structural vulnerability being the one that is exogenous as not depending on their present policy*. This can avoid resorting to an always questionable category of fragile countries, and does not lead to any renouncement of the traditional criteria of performance (or governance), while likely to be improved, and per capita income.¹

According to agreed understanding, a country's vulnerability is the risk that it will be affected by exogenous shocks, either external or natural.

Its structural vulnerability results from the size and recurrence of these shocks, as well as the potential impact they may have on the country due to its economic and social structure. These are economic shocks, climate change shocks or shocks related to political fragility. Their past recurrence evidences their risk for the future. African countries are particularly sensitive to these shocks, through the instability of external demand and of the international price of commodities, which can still constitute a high proportion of exports, through recurrent episodes of natural disasters such as cyclones or droughts, which drastically reduce agricultural production, as well as through the violence phenomena, which are exogenous when linked to terrorism, international drug trade or intrusion of foreign armed gangs, as are exogenous epidemics, which are costly in human lives and in terms of economic activity. In its structural nature, the economic vulnerability of African countries remains strong, as is their political fragility. Climate change, for which African countries are not responsible, risks exacerbating consequences of this political fragility. As it has been evidenced 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 beyond their immediate impact lower the capacity to tackle future shocks.² The structural and multidimensional vulnerability (economic, climatic and societal) of African countries, even differing from country to country, raises a challenge for their domestic policy as well as for the support the international community.

The inclusion of structural vulnerability in the allocation criteria has thus been discussed for the African Development Fund, although a reform has not yet been achieved. Replacing this issue within the overall framework of funding African economies should help to advance, not only the reform of the allocation criteria for the ADF, or even for IDA or IFAD, but more fundamentally, the idea that with regard to the acute

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

2. Cf Guillaumont P. (2009,2019)

and diverse vulnerabilities (economic vulnerability, vulnerability to climate change, socio-political vulnerability to terrorism, vulnerability to Covid 19) it has become essential to help African countries to face them in a preventive way, knowing that all, in varying forms and to various degrees, 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 not only to the governance and income per capita of recipient countries, but also to their structural vulnerability.

In 2012, the United Nations General Assembly (A/RES/67/221, 21 December 2012) in a resolution on the graduation of Least Developed Countries invited development partners to use as criteria for allocating their development assistance the three criteria for identifying LDCs: per capita income, low level of human capital and (structural) economic vulnerability.³ 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).⁴

▶ 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.⁵ This is a fair principle, because structural vulnerability in its various forms is a handicap to the sustainable development of African countries, and international justice, as it is agreed, aims to equalize opportunities between countries. It is also an effectiveness principle, as research undertaken over the past two decades has shown how aid has a greater marginal effectiveness in situations of vulnerability, since it helps cushion shocks.⁶ Finally, implementing this principle is a means of improving the transparency of 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 develop exceptions to the basic rule of performance-based allocation and to make it in practice opaque, to the point that it may have been considered to be not actually applied.⁷ Taking into account structural vulnerability alongside performance in a logical and simple framework makes it possible to better mark the consistent place of performance.

▶ Two challenges: Assessing structural vulnerability and protecting losers

Supposing agreed the principle that structural vulnerability (alongside with per capita income level) legitimates increased aid to Africa and should simultaneously guide its allocation between African countries, two practical objections are to be addressed.

The first is the difficulty of establishing indicators of vulnerability that could be used as criteria for allocating multilateral aid and assessing geographic selectivity of bilateral aid. It should be possible to promote a consensus on indicators, provided that their purpose and method are well established, including their relevance to serve as an allocation criterion: only the vulnerability that is *exogenous with respect to the present policy*

3. https://www.un.org/ga/search/view_doc.asp?symbol=A/RES/67/221

4. 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

5. See Guillaumont et al., 2017

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

7. See Guillaumont and Wagner, 2015

of countries, described above as structural vulnerability, 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 current policy, which is assessed in the performance indicator. Taking into account vulnerability in the allocation prevents the populations of countries with high fragility and weak governance from being penalized twice, by both governance and allocation.

It is also needed that the exogenous vulnerability be captured in *its various dimensions, economic, climatic, socio-political*. It should be noted that the United Nations General Assembly in a December 2020 Resolution 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 its measurement.⁸ This holds 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 “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 politically difficult to apply under a constant envelope: if it increases the share of some countries, it decreases that of others. The mobilization of additional financial resources for Africa should make politically easier a reform of allocation, so that the resulting decrease in the relative share for some countries could occur without an absolute decrease or would mitigate it.

Finally, 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 special drawing rights and the allocation of IMF credits.

► The consequences of debt adjustment in terms of allocation

With regard to debt management, it would be appropriate 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 the treatment of the debt 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. Indeed, the countries for which debt treatment has been necessary are more middle-income countries implementing sometimes 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 is only 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, if only in an indicative way. To do so, all

8. 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>

lending multilateral institutions involved would have to take into account debt relief for them in determining the envelopes allocated to each country. And for the ex post assessment of the geographical selectivity of bilaterals debt relief should also be taken into account.

If there was a global agreement on an optimal 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 articulated with the general allocation principles outlined above. Since SDRs are allocated on the basis of quotas, it is clear that their allocation under this principle 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 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 gain obtained by each African country would not be distributed according to the needs due to 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 needed to agree on the short versus long-term objective of a new SDR allocation. Indeed the exceptional economic shock faced

by African countries as a result of the pandemic and the accompanying global recession has evidenced specific needs. But the allocation of SDRs should be aimed at mitigating medium- and long-term impact of potential future shocks, in other words 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 the rules were to be common (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, either the creation of a specific multilateral fund, an increase of IDA resources, or, perhaps most naturally, of resources of the IMF’s Poverty Reduction and Growth Fund (IDA). The latter option, however, raises the issue of the ceiling set for each country on IMF contributions; 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.⁹ As for the option of switching through IDA or the ADF, it would reinforce the long-term development support character 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).

9. 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 their distribution between countries, alongside the traditional criteria of per capita income and performance. This inclusion does not lead to give less attention to performance, but rather to re-examine its meaning, which should take into account countries' efforts to reduce their vulnerability, in other words to increase their resilience to external shocks.

The willingness of African development partners 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 they are also threatening other countries, especially Europe.

The coherence between the allocation of the various concessional sources of financing of 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 could ensure overall consistency.

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