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# What the Covid-19 economic crisis could change to the development finance agenda

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For the second time over the last ten years, low-income economies are confronted with the challenge of overcoming a macro crisis they did not spark and for which they have disproportionately poor capacity to cope with compared to high-income countries. In this context, development finance institutions (DFIs) have an important role to play, both during the crisis and for the recovery. Some of them already made announcements. But the role of DFIs cannot be the one pre-existing, which assumed that solvability and borrowing capacity would rise along sustained GDP growth. GDP growth is coming to a halt, which leads the DFIs to revise their plans. In this post, we explore some key recommendations for these new plans, particularly for European DFIs in a geopolitical context where other countries are already more visible for their relief and emergency interventions.

## A heavy blow for poor countries: DFIs need to step up

The Covid-19 turned into a major economic crisis for low-income countries well before the pandemic peaked in these countries. And containment and lockdown measures are expected to bring additional economic hardship in countries where informal jobs make up for 75% or more of labour earnings and cannot be supplied on a remote basis. In Africa however, governments acted promptly to limit the spread of the disease. The incapacity of the health system to cope with an overshoot in critical cases left but no other choice than to focus on prevention. But low health capacities are but one of the problems poor countries are facing.

Limited fiscal space puts a strain on their capacity to tweak a health and economic recovery package, contrary to OECD countries. Central banks injected the limited liquidity they owned. National development banks took over and increased lending for local companies to the extent possible. As a result, budget deficit has already doubled in many countries, and debt distress is looming. Calls multiply to the IMF for short-term emergency relief.<sup>[1](#)</sup>

Worryingly, the joint call on March 25, 2020, from IMF and the World Bank, joined by President Macron on April 13, for a moratorium on debt payment to official bilateral creditors for countries that request forbearance did not spark much reaction, to say the least, among bilateral donors to which China can be included. G20 announced on April 15 debt service suspension for the poorest countries until December 2020, but interests are still running, and the issue of debt restructuring and partial cancellation remains taboo. It would however be a historical mistake for OECD's Development Assistance Committee (DAC) countries to consider the Covid-19 economic crisis as another crisis adding up to a long series of booms and busts they are not concerned with bilaterally. There are plausible reasons for poor countries, and particularly African ones, to make this crisis an opportunity to deeply transform the relationships among themselves and advance the Africa-as-one agenda.<sup>[2](#)</sup> It is true also for their relationships with DAC countries: The "billion-to-trillion" narrative cherished by DFIs, with its promise of public and concessional loans leveraging private investment for a myriad of "bankable projects", might fall short of delivering any relief to countries in dire need of well-performing health systems, additional budget capacities and fiscal resilience to cope with shocks. There is no flurry of "bankable projects" solving this.

## Development strikes back

This crisis puts back to the fore two classic tenets of development cooperation practice that were being forgotten: that development is intrinsically a geopolitical phenomenon which Europe should seize as such, and that sustained support in fiscal resilience in developing countries is just as helpful, if not more, than investing in specific infrastructure projects.

The lessons from existing recovery plans seem quite straightforward: double public spending and unleash public debt, as long as creditors do not charge you too much for this. And if you are poor, beg for debt relief and call for help—even in-kind, with masks, test kits and other materials. The ones coming into Africa fly from China, who is helping Africa with material and grants to solve the Covid-19 crisis while EU Member States are not, or much less. The "partnership of equals"<sup>[3](#)</sup> put forward by the European Commission in its dialogue with African countries is therefore at risk.<sup>[4](#)</sup> The first consequence is that development strikes back primarily as a geo-political phenomenon.

Development strikes back in a second manner. The idea that States' budgets should be resilient to external shocks is an old tenet of development thinking. But export revenues and buffer fund price stabilisation mechanisms have been progressively abandoned, the fiscal basis has not widened much, and public spending as a share of GDP remains

twice as low in low-income countries as in OECD countries on average—and up to 3 times if we include social security spending. Export and import levies, and commodity-specific profit taxes, make the bulk of government revenues, which inevitably dwindle when world market prices collapse. Investing in fiscal resilience suffers from being much less visible than spending aid on “hard” development projects such as dams, roads or vaccines. DAC spending on fiscal collection capacity enhancement is close to zero as a share of total Official Development Assistance (ODA). However, generating income is unsustainable if not accompanied with improved fiscal and administrative capacities—a developmental state, not to name it.

## Be fair to be green

Poor countries are the main losers of the current economic crisis. So that DFIs should take stock of what this crisis tells about economic resilience and fiscal inequalities among nations, revise their strategy and align their business plan accordingly. A few related suggestions below.

Do not save development money when your own country does not save money for itself. The priority for donor countries and their DFIs should be to avoid the widening of the North-South divide between the haves (a recovery plan) and the haves-not. A cynical move would be to fund a Marshall Plan in Europe for Europe without injecting a record-high amount of cheap and fresh money into poor countries' economy. In this context, early announcements from the G20 or the European Commission's either do not live up to the magnitude of the challenges or have to be clear on what kind of money is on the table (hopefully genuine additional money and not remaining European funds redirected toward the management of the crisis). The joint call from African and EU leaders for a huge economic stimulus package to Africa of at least \$100bn needs is timely, but also needs further clarification on burden sharing and practicalities.<sup>5</sup> For its part, the French Development Agency (AFD) pledged a €1.2 billion initiative in response to the public health crisis, €1 billion of which as loans partly for on-lending to national development banks—the levels of concessionality and additionality of which were not communicated when this blog was written. If moving up ODA to 0,7% of national income through debt partial cancellation and/or increased cheap on-lending to local banks according to circumstances has ever made any sense, it is now.

Prioritise fiscal resilience capacity building programs. Loan-based and equity-based development finance spurs economic growth and income generation, but there are basic public goods and public good provision capacities to finance without which income generation turns impossible—or unsustainable when a crisis hits. Covid-19 is a simple reminder of this. The informality of the economy in is no excuse for abysmal tax-to-GDP ratio: it is as low as 6% in a country like Nigeria; it is rather an opportunity to concentrate wealth among the happy few and eschew accountability in delivering public goods to the many. This implies for donors and DFIs to step up investment and financial support to enhance tax collection and expenditure accountability mechanisms with governments in dire need for support now, even though these might have been high-hanging fruits in their business plan so far.

Upscale adaptative social protection systems. Resilience could be much improved at sectoral and micro level as well. European DFIs, in conjunction with international and local DFIs, have a critical role to play in supporting micro, small, and medium enterprises (through financial intermediaries) most affected by the crisis.<sup>6</sup> This is particularly true in the agricultural sector, which is a prominent employer and economic buffer. “Adaptative social protection” (ASP) programs could also be ramped up. They have been experimented recently to promote greater integration between social protection and climate change adaptation in informal economies, to cope with crises and build resilience against a wide range of shocks and stresses in close connection with humanitarians. They are more “reactive” than conventional cash transfer programs. Most of the social protection programmes however that have been explicitly designed to address the impacts of climate change are located in South Asia and East Africa. ASPs could be expanded across poor and vulnerable countries, for their contribution to building resilience to a large spectrum of

shocks.

Bind green investment pathways to social spending scenarios. The transition toward low-emission development pathways has taken high profile among DAC donors and some DFIs over the last decade or so, the portfolio of which is now regularly subjected to climate-proofing mechanisms. The progressive greening of donors and DFIs' portfolio comes up with updated estimates of long-term green (or low-carbon) investment needs, based on carbon budgets, available technologies and emissions scenarios. Green investment needs should be revised upward, and include explicit estimates of social expenditures needs, and related policy packages. The Covid-19 crisis shows in particular that with oil price at US\$ 20 per barrel (something which could become the new normal in 2°C low-carbon scenarios), major African economies like Ghana, Nigeria, Congo-Brazzaville, and Angola are severely hurt—the effects of confinement aside. The transition towards a green economy could come along with similar shocks well before the SDG deadline of 2030: inconsistent budget for social expenditures and buffer mechanisms would then be a killer of green policies. Shifting away from oil to embrace a low-carbon economy is also the best means to alleviate the consequences of fossil energy markets downswing, and supporting a fair and resilient social protection system is the primary genuinely “green” policy permitting this to happen.

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<sup>1</sup> As of April, 1st, 2020, 85 developing countries called for IMF assistance –meaning twice as much as in 2008-2009.

<sup>2</sup> [https://www.lemonde.fr/afrique/article/2020/04/04/apres-le-coronavirus-une-autre-afrique-est-possible-et-ce-n-est-pas-une-utopie\\_6035567\\_3212.html](https://www.lemonde.fr/afrique/article/2020/04/04/apres-le-coronavirus-une-autre-afrique-est-possible-et-ce-n-est-pas-une-utopie_6035567_3212.html)

<sup>3</sup> <https://www.iddri.org/en/publications-and-events/blog-post/can-green-deal-be-core-eus-project-its-external-partnerships>

<sup>4</sup> [https://ettg.eu/2020/04/06/europe-africa-relations-after-corona/?utm\\_source=ECDPM+Newsletters+List&utm\\_campaign=973c15b66f-EMAIL\\_CAMPAIGN\\_2020\\_03\\_16\\_09\\_10\\_COPY\\_01&utm\\_medium=email&utm\\_term=0\\_f93a3dae14-973c15b66f-388685097](https://ettg.eu/2020/04/06/europe-africa-relations-after-corona/?utm_source=ECDPM+Newsletters+List&utm_campaign=973c15b66f-EMAIL_CAMPAIGN_2020_03_16_09_10_COPY_01&utm_medium=email&utm_term=0_f93a3dae14-973c15b66f-388685097)

<sup>5</sup> <https://www.ft.com/content/8f76a4c6-7d7a-11ea-82f6-150830b3b99a>

<sup>6</sup> [https://set.odi.org/wp-content/uploads/2020/04/How-can-the-European-Union-help-developing-countries.pdf?utm\\_source=ECDPM+Newsletters+List&utm\\_campaign=973c15b66f-EMAIL\\_CAMPAIGN\\_2020\\_03\\_16\\_09\\_10\\_COPY\\_01&utm\\_medium=email&utm\\_term=0\\_f93a3dae14-973c15b66f-388685097](https://set.odi.org/wp-content/uploads/2020/04/How-can-the-European-Union-help-developing-countries.pdf?utm_source=ECDPM+Newsletters+List&utm_campaign=973c15b66f-EMAIL_CAMPAIGN_2020_03_16_09_10_COPY_01&utm_medium=email&utm_term=0_f93a3dae14-973c15b66f-388685097)

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