AFRICAN DEVELOPMENT BANK GROUP
AFRICAN DEVELOPMENT INSTITUTE

CONCEPT NOTE

Managing Public Finance in Times of Crisis in Africa

A Brainstorming E-Policy Dialogue

Hosted by African Development Institute, African Development Bank Group under the auspices of the Global Community of Practice on Covid-19 Response Strategies in Africa (G-CoP)

28 February 2022, Time 14:00 – 17:00 hours (GMT) Western Hemisphere
01 March 2022, Time 08:30 – 11:30 hours (GMT) Eastern Hemisphere

Context: *The Covid-19 Pandemic did not entirely create Africa's public finance management challenges. It exacerbated them. Although the Covid-19 induced recession is set to be the deepest since the second World War-induced recession in 1945-46, and more than twice as deep as the recession associated with the 2007- 2009 global financial crisis, it is not the first, neither will it be the last. Africa's sustainable recovery from the fiscal impacts of Covid-19 will largely depend on the availability and efficient management of affordable financing for inclusive and sustainable development in Africa. Without such financing and prudent public finance management system, the continent will not be able to achieve the 2030 global Sustainable Development Goals. Also important for sustainable recovery are reforms of PFM systems, as well as fiscal and monetary buffers that minimize the impact of more frequent minor crisis (e.g., conflicts, environmental, periodic commodity price oscillation, forex reserves crisis, and exchange rate depreciation).*

1. INTRODUCTION

The global economy has experienced several recessions since 1873. The Covid-19 recession is set to be the deepest since the second World War-induced recession in 1945-46. It is more than twice as deep as the recession associated with the 2007- 2009 global financial crisis.

However, Covid-19 did not create the public finance management challenges in Africa. It exacerbated them. Before the pandemic, the African Development Bank estimated Africa's infrastructure financing gap between $68 billion and $108 billion per year. Government revenue was lower than in other regions, fiscal deficits and debt vulnerabilities were already on the rise. In addition, Africa was losing about $89 billion (about 3.7% of its gross domestic product (GDP)) in illicit financial flows due to leakages in its public finance management systems, among other factors. Several African countries faced significant fiscal challenges before the inception of the pandemic in 2020.

The Covid-19 has exacerbated the challenges of financing the 2030 sustainable development goals (SDGs), the 2015 Paris Climate Agreement, Africa's Agenda 2063, and national development goals across the continent. It has impacted Africa's macro-economic outlook, debt vulnerabilities, lives and livelihoods, and financial flows in fundamental ways, reversing decades of progress on the continent. It has, no doubt, deepened the need for enhanced mobilization and prudential management of scarce public finances to deliver development impacts.

Africa's fiscal deficits doubled in 2020 - rising to a historical high of 7.2% of GDP[1]. Government revenues declined on average by 10 to 15% in 2020 across sub-Saharan Africa. Currently, Africa's public debt is estimated at $546 billion. This is about one-quarter of the continent's GDP and higher than its annual government revenues ($501 billion). Some 18% of Africa's annual government revenues is used to service debt. Due to Covid-19, the debt-to-GDP ratio is likely to rise by 10% to 15% in the short to medium term, further squeezing the fiscal space for countries. Furthermore, inflation jumped from an average of 9.2% in 2019 to 10.8% at the end of 2020.

The pandemic has also impacted other sources of development finance inflows. Compared to 2019, in 2020, foreign direct investment (FDI) to Africa declined by 15.6% (from $47.1 billion to $39.8 billion), overseas development assistance by 10% (from $52.9 billion to $47.6 billion), and portfolio investments by 212% (from a net inflow of $14.3 billion to a net outflow of $16 billion) as investors' greater perception of risks induce capital flight from Africa. Access to international capital markets also decreased with the widening of spreads on African sovereign bond yields. Efforts have been made to cushion this decrease through the roll out of loans such as the AfDB's Crisis Response Facility and the IMF's Rapid Credit Facility, as well as Special

[1] This is a revised estimate based on actual data available as of 31 December 2021. The African Economic Outlook published by the African Development Bank Group at the beginning of 2021 had estimated that fiscal deficits could rise to 8.4% by the end of 2021. The downward revision is due to a rise in commodity prices, resumption of economic activities including tourism as COVID-19 lock-downs were eased in 2021.

Drawing Rights (SDR) allocation to member-states. However, these are not sustainable sources of financial inflows because most of these facilities are one-off in nature.

Today, African countries are left with very little to finance infrastructure and social expenditures needed to cushion the impacts of the pandemic. In addition to financing their national priorities, African countries also lack the sustained long-term financing needed for achieving the SDGs, the Paris Climate Agreement and Agenda 2063. The African Development Bank estimates that African governments will need some $484 billion within the next three years to address the socio-economic impacts of the pandemic and support economic recovery alone.

In Africa, real GDP growth is expected to rebound in 2021, with stable outlook in 2022 and 2023. IMF's Regional Economic Outlook of October 2021 shows an updated forecast of 3.7% and 3.8% for Sub-Saharan Africa for 2021 and 2022, respectively. Following a contraction of 2.1% in 2020, this is good. However, our updated estimates show that about 26 million Africans were already pushed into extreme poverty in 2020 and about 30 million more expected between 2021 and 2023. Several businesses are permanently closed. There is rising long-term unemployment, consumer price inflation, and significant disruption in human capital formation for millions of African children. Policy responses to Covid-19 has also left significant inequalities in its wake, with the spill-over effects of the unprecedented fiscal and monetary policy easing by countries expected to deepen the challenges of fiscal and monetary policy management in the short to medium terms, especially in the low-income developing countries and emerging markets. It is expected that the long-term structural impacts of the pandemic may outweigh its short-term fiscal impacts in Africa.

In addition, the impacts of other exogenous factors – beyond African governments' control – such as global climate change, swings in (exportable) commodity prices, and security expenditures might further worsen the credit ratings of countries, and hence increase the cost of capital and the financing needs of affected countries. The estimated financing needs for countries to achieve poverty eradication and other sustainable development goals in a post-Covid-19 world further deepens the PFM challenges in Africa.

By putting significant pressure on already strained government finances, the pandemic is forcing African scholars to rethink the prevailing development finance architecture. Many argue that the entire financing ecosystem of African economies should be rethought. This includes rethinking from a legal perspective, to facilitate private sector financing, strengthen property rights, access to guarantees for micro, small, and medium-sized enterprises, and innovative and inclusive models that can make more low-cost financing available for low-income countries.

The African Development Bank preliminary estimates suggest that the annual financing gap to end extreme poverty by 2030 is about 30.6% of GDP, or $19.1 billion, on average, per country between 2021-2030. It is noteworthy that this estimate did not factor in the impact of Covid-19 between 2021 and 2030 nor other potential factors likely to affect extreme poverty levels (conflicts, climate change, etc.). In addition, a recent report by McKinsey & Company, estimates that global capital spending on physical assets for energy and land-use systems in the net-zero transition[2] is about $275 trillion, or $9.2 trillion per year on average between 2021 and 2050, an annual increase of as much as $3.5 trillion[3]. The report notes that this spending would be front-loaded, rising from 6.8% of GDP today to as much as 8.8% of GDP between 2026 and 2030 before falling. Introducing new sources of revenue to finance public programmes in a sustainable manner, as suggested in this paper, alongside the critical improvements to PFM, cannot, therefore, be overemphasized.

Covid-19, like climate change, commodity price oscillation, and global security, is a global commons problem. Global action is required to urgently address the impacts of the pandemic everywhere. Thus, increasing development finance flows to support sustainable recovery and economic stabilization programs in Africa and the developing countries is critical for global recovery from the pandemic. Many African countries were not on track to achieve the SDGs prior to Covid-19 pandemic. Without increased financing for development and prudent management of public finances, the global Sustainable Development Goals, the Paris Climate agreement, and Agenda 2063 will not be achieved.

2.1 What we can learn from history?

Several trends often follow global economic recessions. They include rising public debt, an uptick in inflation, tax rate increases, and a decline in consumption and investment. These can have significant negative impacts on economic recovery and growth rates, especially for low-income countries. The availability of capital to invest in businesses, technologies, and industrial production defines the winners and losers in post-crisis periods. Filling the supply gaps required to meet the resurgence in aggregate demand as populations emerge from the crisis requires increased investments in diversified productive sectors. During and after each global shock, the capacity of countries to manage both the mobilization and prudent use of public resources is critical to their rate of recovery and resilience potential.

The Covid-19 pandemic has exposed the limitations of the current global cooperation systems in several ways. There has been an unprecedented easing of fiscal policy by the developed countries to rescue their economies even as vaccine inequality lingers. The total fiscal policy measures implemented in response to Covid-19 pandemic (including above the line measures and liquidity support programs) from January 2020 – September 2021 is estimated to be around US$17 trillion, almost US$13.5 trillion of which were implemented by the G-20 advanced economies and about US$1.8 trillion in the G-20 emerging markets. Other selected advanced economies accounted for about US$1.1 trillion in fiscal measures implemented during the period. Only about US$0.584 trillion in fiscal measures (about 3.5% of the total measures implemented globally) were implemented in other emerging markets and low-income developing economies. In effect, over 90% of the fiscal measures implemented globally in response to Covid-19 pandemic were implemented by the 10 G-20 advanced economies (Figure 1).

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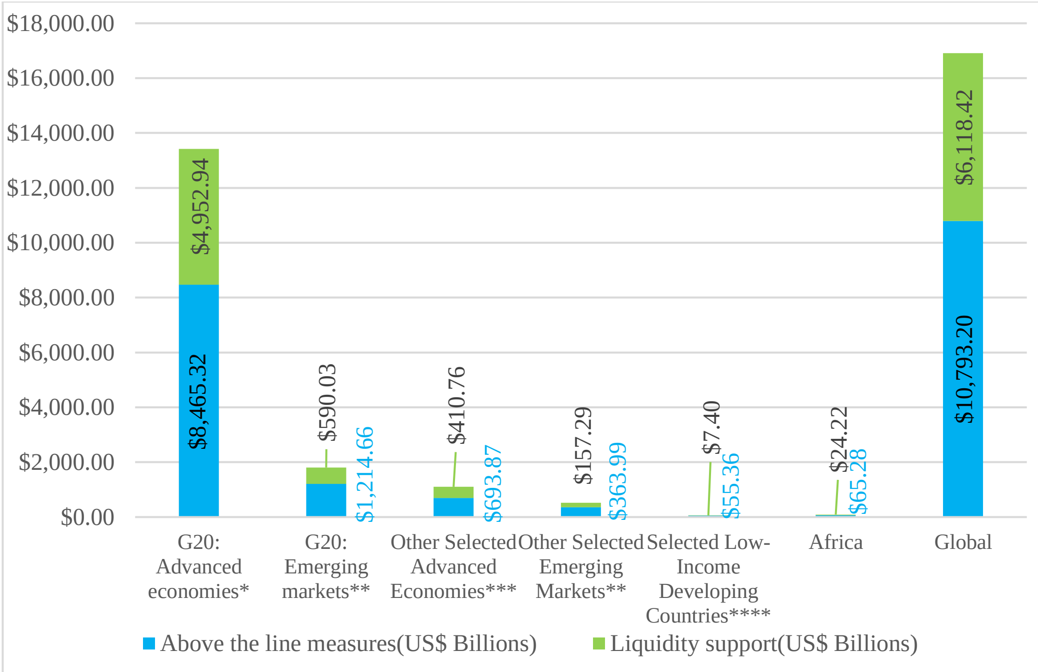
[2] Based on the COP21 Paris Agreement in 2015, the Energy Transition to net zero greenhouse gas emissions is defined as the downshift of fossil fuel production to stay within the carbon emissions budget to limit global warming to 1.5 °C.
[3] Boston et al, 2022. The net-zero transition – what it would cost, what it could bring. McKinsey & Company, January 2022. The net-zero transition: Its cost and benefits | Sustainability | McKinsey & Company

Figure 1: Summary of Fiscal Measures in Response to the Covid-19 Pandemic, January 2020 – September 2021 (in US$ Billion)



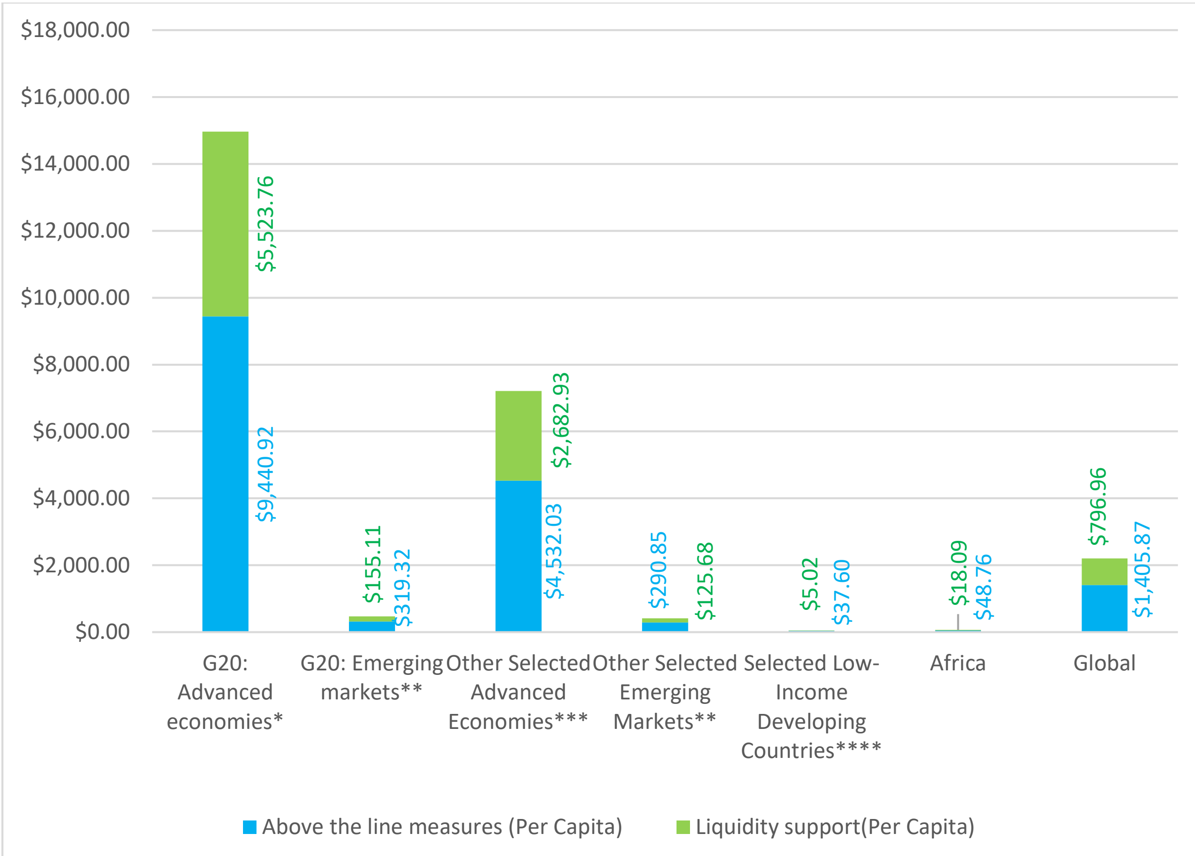
Source: Computed from: Data from National Authorities and IMF Policy Monitor as of Sep 27, 2021[4]

The total fiscal measures implemented by African countries during the period is estimated to be about US$89.5 billion (about 0.5% of the total fiscal measures implemented globally)[5]. The fiscal measures implemented in the G-20 advanced economies and Africa during the period in US$ per capita are estimated at out US$14,964.68 and US$66.85, respectively (Figure 2). Specific country comparisons show significant inequities.

[4] For classification of country groups, see https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19. The estimate of fiscal support includes above-the-line measures of additional spending and foregone revenue, as well as below the line measures and contingent liabilities from guarantees and quasi-fiscal operations. The estimates are based on author's calculations as of 30 January 2022. Updates may become necessary as more data become available.

[5] About US$30 billion of these fiscal measures were implemented by South Africa, which also reported the highest number of Covid-19 infections in Africa so far.

Figure 2: Summary of fiscal measures implemented between January 2020 and 27 September 2021 (US$ per capita)

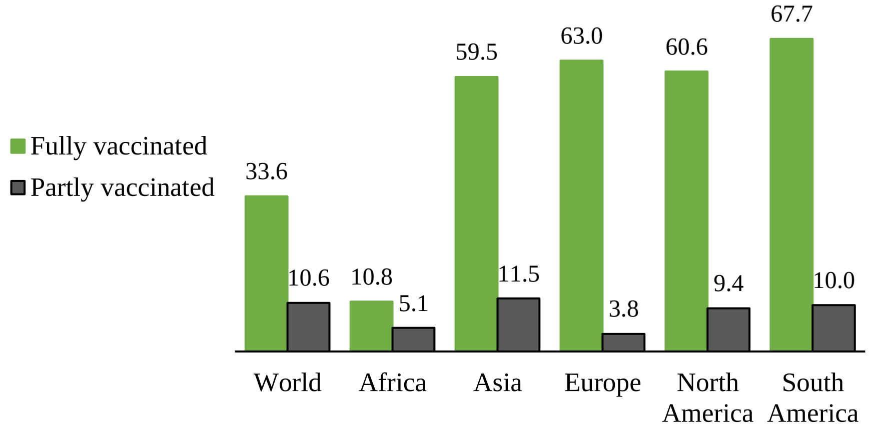


Source: Computed from: Data from National Authorities and IMF Policy Monitor as of Sep 27, 2021.

The rates of distribution and inoculation of citizens with Covid-19 vaccines have been unequal. Based on available data as of 31 January 2022, about 34% of the world population were fully vaccinated (received up to 2 doses of Covid-vaccines). The rates of vaccination of citizens have followed similar regional differentiations as in the fiscal stimulus roll out. About 61% of European residents were fully vaccinated as of 31 January 2022, and the same statistic for South America, North America, Asia, and Africa were about 68%, 61%, 60% and 11%, respectively (Figure 3). The difference is clear.

The low rates of vaccination in Africa begs questions regarding the collective resolve of the global community to work together in times of crisis, even when it is for the common good of all stakeholders. While it is good politics for countries to focus on vaccinating their own citizens first at least in the short term, the epidemiology of Covid-19, its origins, rates of mutation and spread has so far demonstrated the true nature of global commons problems like Covid-19. The actions of one agent may not lead to a sustainable solution if all agents do not act likewise. When there is Covid-19 anywhere, there is Covid-19 everywhere.

Figure 3: Global Covid-19 Vaccination Status by Region as of December 31, 2021



Source: Computed from Covidvax.live in Data – as of January 31, 2022.

The paltry levels of vaccination rates in Africa, rising debt liabilities (including commitment and expenditure arears), and state-contingent liabilities continue to create triangles of disaster for African countries in the near to long term post-pandemic period.

2.2 What can be done now?

Previous policies to address global economic shocks centered around fiscal and monetary policy easing to provide immediate economic relief to businesses and households. Quantitative easing, asset purchase programs, debt service suspension and debt restructuring, tax holidays, and other furlough programs sustain economic activities during the shock and support recovery in the short term. In the longer-term, debt cancelation or forgiveness and structural adjustments, and economic reform programs, are needed to stabilize economies.

Experience show that short-term reactive policies can have unwelcome effects in the medium term, such as an uptick in inflation and increased inequality due to reallocation of incomes towards the rich, and other short-term fiscal consequences. The unprecedented high-level of fiscal stimulus provided by the advanced economies could pose some risks in the medium to long term, especially in the emerging markets and low-income countries. For example, asset purchase programs could pose risks to central bank independence and price stability in developing economies. If not carefully managed, they can become addictive and lead to fiscal dominance, excessive risk-taking, and debt monetization. This can, in turn, hurt central bank balance sheets when they buy sovereign or corporate debt when interest rates are low across maturities if rates increase sharply afterwards.

Like climate change, biodiversity loss, water pollution, global security, Covid-19 has demonstrated our common future and the need for global action to address global commons problems. Urgent global action is required to find more innovative ways of ensuring a more inclusive and sustainable recovery, long-term stabilization of the global economy and future resilience. There is urgent need for better-focused policy support to African countries, structured within a framework that incorporates both “crisis management” and “post-pandemic resilience and green recovery". Such policy support should include a focus on Africa's fiscal policy options and needed public finance reforms and capacity development in line with policy priorities and lessons learned from international and regional best practices in attaining "growth-based" policy targets. Lessons from previous policy responses to previous crises in different regions of the world, including Africa can provide opportunities for innovation in crafting more sustainable responses to Covid-19.

Against this backdrop, the African Development Institute is hosting an e-policy seminar under the Global Community of Practice themed "*Managing Public Finance in Times of Crisis in Africa*". The e-seminar is scheduled for 28 February 2022 from 14:00 – 17:00 hours (GMT) and on 01 March 2022 from 08:30 – 11.30 hours (GMT). The two sessions aim to accommodate delegates from different time zones in the Western and Eastern hemispheres, respectively.

The seminar is expected to be hosted in collaboration with the World Bank, IMF, and other leading anchor global and African institutions working in the African public finance management (PFM) space. The e-policy seminar will form the first part of a 5-day focused policy dialogue and tailored executive training program on the same topic: "*Managing Public Finance in Times of Crisis in Africa*". The second part will constitute a 3-day executive training program that will delve into more practical tools and offer implementable policy options and practices in Africa and globally, based on some of the outcomes of the G-CoP Seminar.

3. OBJECTIVES

The objective of the G-CoP Seminar is to bring together certified global experts and global institutions working on PFM in Africa as well as anchor PFM institutions to rethink the approach to managing public finances in times of crisis. Specifically, the seminar will focus on addressing the following questions:

1. What are the key policies and strategies deployed in managing public finances during global financial crises in the past? What worked and what did not work, and what lessons can be learned for managing the short-, medium-, and long-term implications of current policy responses to Covid-19.

2. What are the case examples of good and bad practices in managing public finances during the Covid-19 pandemic? What can be learned to improve public finance management practices and build fiscal resilience in Africa post-Covid-19? How can we improve: (a) revenue mobilization, (b) public expenditure management, and (c) PFM legal and institutional frameworks, systems, process, and tools to better manage the crisis and rebuild economies?

3. What strategies, actions, and instruments can be used by Ministries of Planning and Budgets, Finance/Treasuries, Debt Management Offices, and legislatures to strengthen fiscal resilience readiness for future global crises such as Covid-19? What lessons can be learned from the past and current crisis?

4. What practical actions, if any, should African Central Banks and monetary authorities (including regional banks, and other international financial institutions) take to support public finance management in times of crisis and post Covid-19?

5. How has Covid-19 affected the financing of non-health public service delivery in countries; what examples of good and bad practices were observed; and what lessons for future crises? What are the implications for investments in quality health care infrastructure in good times?

6. During commodity and environmental crises, how does subsidy for petroleum, utilities and agriculture affect allocations to the social sector, especially health and education?

7. How did the disruptions in global trade and supply chain affect the public finances of African countries; how did countries respond to these; and what counter measures should be put in place to mitigate this risk in future?

8. What public financial management mechanisms can African countries deploy to scale up Covid-19 vaccine coverage, as well as strengthen local vaccine research and production capacity both for current and future health crises?

9. What are the potential public finance management implications of net zero transitions in Africa? What are the potential costs, benefits, and co-benefits to developed and developing economies? What measures are required to address the distributional effects on developed and developing countries, especially Africa?

10. What policy measures are required to mitigate [blockade or tightening of market access, especially, L-MICs—role of Ratings Agencies during crisis?] increasing debt sustainability challenges in Africa in the short, medium, and long term? How can Africa prevent a re-occurrence of the HIPIC experiences post Covid-19?

11. What role can multi-lateral development finance institutions such as the AfDB, IMF and World Bank, other DFIs and bilateral development agencies play to improve the global responses to global commons challenges such as climate change, Covid-19, and global security challenges; and how can these support sustainable public finance management?

12. What are the key roles of the private sector in enhancing public finances in times of crisis? What lessons can be learned from the past and current global crisis?

13. What are the implications of fiscal risk management and reporting, and country risk rating for public finance management in times of Crisis?

14. What PFM policy priorities, trade-off in budget allocation, and tough choices must countries make to achieve resilient and sustainable PFM Systems?

The focus will be on identifying and prioritizing innovative and implementable policies and strategies that can support Africa's efforts to mobilize and manage public finances better during and after the pandemic and build fiscal resilience post-Covid-19.

4. IMPLEMENTATION

The G-CoP seminar shall be anchored by Speakers selected by the lead partner institutions. Key institutions working on PFM in Africa including the International Monetary Fund (IMF), the World Bank Group, the IMF Africa Training Institute (ATI), AFRITACs, and others have been invited as Partners. The heads of a select group of pan-African institutions working on PFM and serving/former Ministers, Central Bank Officials and other government agencies will also be invited to share their experiences during the policy seminar. A select group of accredited international experts and practitioners (the African Development Bank's Policy Lab Unit) shall constitute the faculty to deliver the tailored training program.

The program is designed to provide practical options for a better administration of their fiscal and budgetary policies, and for strengthening the resilience of their PFM systems in times of crisis. All individual contributions to the seminar shall be treated under African fire side chat / Chatham House Rules.

5. PARTICIPATION

The G-CoP policy seminar will convene global experts and practitioners on PFM from Ministries of Planning and Budgets, Finance/National Treasuries, Central Banks, Universities, pan-African and global institutions working on PFM, and provide platform for experience sharing and peer to peer learning among stakeholders. Participation in the G-CoP seminar shall be open to all registered delegates from Africa and globally.

The follow-up 3- day executive training program will target trainees nominated by the responsible government agencies in Africa. Only trainees nominated by the responsible parent Ministries/Government Agencies in African countries and who are duly registered and accredited by the African Development Bank Group shall be admitted to the 3- day executive training course. This will be the inaugural part of a structured training program to be delivered to cohorts of Trainees from African government agencies over the period of 12 – 18 months, covering the key areas of PFM cycle in practice.

6. CALL FOR PARTICIPANTS

To participate in the G-CoP e-seminar on "*Managing Public Finance in Times of Crisis in Africa*", please click here or scan the image with your phone Camera to register or send an email to adigcop@afdb.org**.** Registration should be received by the African Development Bank Group by the **21st of February 2022**.

Participants for the 3-day training program shall be nominated by the relevant Ministries and Government Agencies in direct communication with the African Development Institute, African Development Bank Group.

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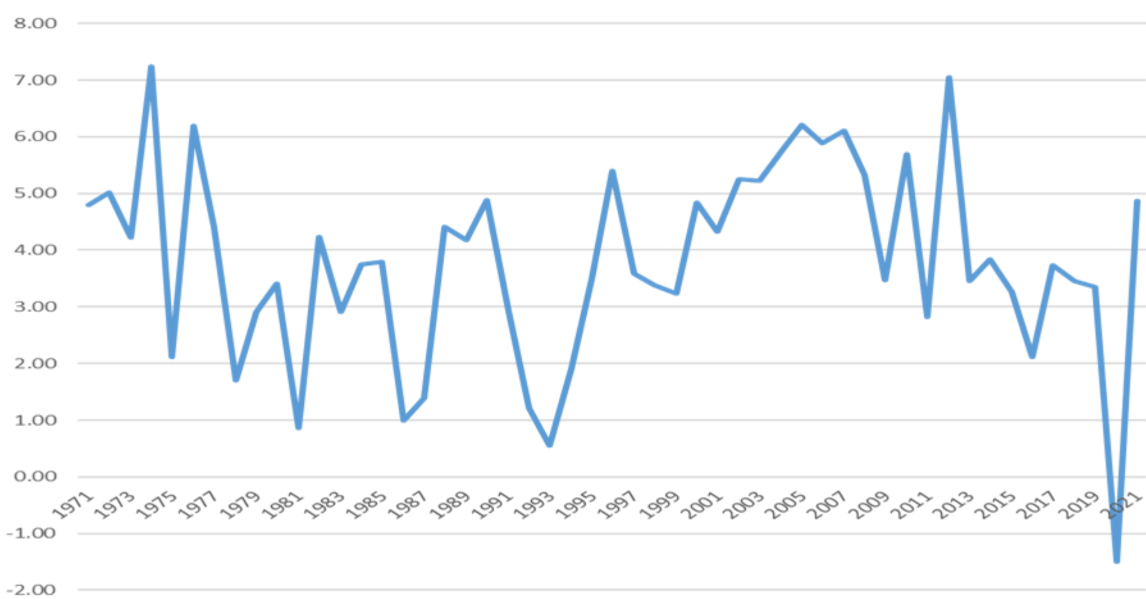
Annex 1: Impacts of Covid-19 on Africa and Implications for post-Covid-19 Public Finance Management

1 **Africa has been under the burden of multiple crises ranging from Ebola, SARs, Bubonic Plague, droughts and famine, volcanic eruptions, insecurity, and civil and political conflicts. These have had perversive adverse effect on the economies and livelihoods of populations in the continent. However, the Covid-19 pandemic has had the most devastating impact on economic growth of all African countries in 2020 and recovery remains uncertain.** Prior to the pandemic, Africa was on a robust economic growth path, with real GDP growth averaging about 4.6 percent in the two decades prior to 2019. Moreover, more than half of the top ten best-performing economies globally during this period were from Africa, with countries that are more diversified and less dependent on the export of natural resources, such as oil and gas, leading the pack. The strong pre-pandemic growth performance was attributed to better macroeconomic management, favorable commodity prices, relative peace and stability, improvement in investment climates, and increased digital connectivity.

2 **In 2020, Africa faced its worst economic recession in over 50 years due to the negative impacts of the Covid-19 pandemic.** The African Economic Outlook report (AEO, 2021) estimated that Africa's real GDP contracted by 2.1 percent falling by 6.4 percentage points from the pre-Covid-19 expected growth for 2020 (Figure 4)[6].

Figure 4: GDP growth rates (%) in 1971 – 2021



Source: African Development Bank Statistics Department

[6] The figure is based on revised estimates as of 31 December 2021.

The impacts of the pandemic on the African continent have been far-reaching, affecting output, productivity, food supplies, lives, businesses, jobs, economic structures, human capital accumulation (school closures), and tourism. It has also had other indirect negative impacts on several economic sectors.

Fiscal deficits widened to 7.2% of GDP in 2020, from 4.3 percent in 2019, mainly due to heavy stimulus spending by many countries to alleviate the pandemic's economic impact. The fiscal measures included above-the-line budgetary support through investments in health systems, expansion of social protection programs, and support to the private sector, for example through tax relief.

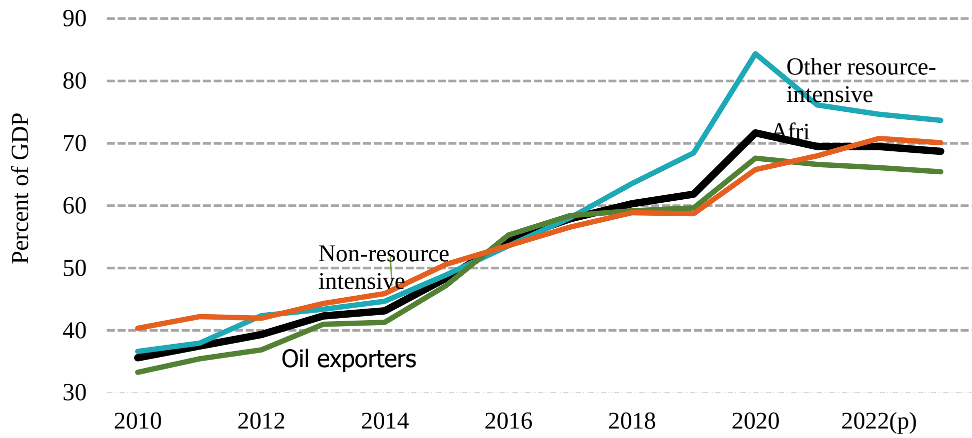
3. Government revenues declined on average by 10 to 15% in 2020 across sub-Saharan Africa. Countries experienced significant currency and exchange rate depreciations, uptick in consumer price inflation, and declining trade volumes in 2020. Although the AfDB's estimates a recovery in 2021, with a stable outlook in 2022 and 2023, these projections are subject to: increased Covid vaccination rates, sustained rise in commodity prices; ability to contain the impacts of new variants such as Omicron and non-emergence of new variants; capacity to resolve sovereign debt vulnerabilities, potential spillovers from the tightening of global financial conditions, supply chain disruptions, climate and environmental concerns, socio-political issues; and availability of affordable resources to finance sustainable and resilient recovery in African countries. The recent emergence of new variants of the virus and the associated border closures and lock-down of economic activity raise renewed concerns about the risk of further deceleration in growth.

One lesson from Covid-19 is that health and economic policies are intricately linked. Vaccination has, for example become the most effective policy to fight the pandemic and restore economies. Energy and food prices and currency movements have been major factors driving the inflationary trend. In addition, sharp withdrawal of monetary accommodation policies by Central Banks could hurt their own balance sheets in the medium term.

4. The pandemic has exacerbated the debt vulnerabilities of African countries

Increased public expenditures, growth contraction, and a drop in revenues due to the pandemic has resulted in fast-paced debt accumulation in African countries. Africa's gross government debt as a percent of GDP nearly doubled between 2010 and 2020, from 36% to 71% (Figure 2).

Figure 5: Gross government debt (% of GDP) 2010 - 2023



Source: Computed from IMF World Economic Outlook database

Currently, Africa's public debt is estimated at $546 billion. This is about one-quarter of the continent's GDP and higher than its annual government revenues ($501 billion). The fast-paced debt accumulation has increased the cost of debt servicing in the continent. On average, some 18% of total government revenue is currently used to service debt. The debt-to-GDP ratio is likely to rise by 10 to 15% in the short to medium term, further squeezing the fiscal space for countries. This has further constrained government efforts to provide social services such as education and health that form the basis for sustainable and inclusive growth.

The structure of debt has been shifting away from traditional sources (multilateral and Paris Club lenders) toward commercial creditors and non-Paris Club members, in particular China. By the end of 2019, bilateral creditors, mostly Paris Club members, accounted for only 27% of Africa's external debt stock, nearly half of their share in 2000. By contrast, the share of debt owed to private creditors has more than doubled, from 17% in 2000 to 39 percent in 2019.

The rising debt levels in the past decade have negatively affected debt sustainability ratings, particularly for low-income countries (LICs) in Africa. As of end-October 2021, 55% of 38 African countries with available data were either in or at risk of distress (15 in high risk of debt distress and 6 in debt distress). Seventeen countries have a moderate risk of debt distress. All this even with the recent allocation of Special Drawing rights (SDRs) by the IMF. With safety margins being eroded by the Covid-19 pandemic as spending rises and revenue falls, rising debt, if not properly managed, could deplete the buffers of distressed or near distress countries before the pandemic is fully controlled.

The shift in debt composition has been associated with less transparent loan terms; the "race to seniority" from debt collateralization; domestic arrears accumulation; increasing contingent liabilities from state-owned enterprises and public-private partnerships; all contributing to increasing debt vulnerabilities. Increased external financing through non-concessional market instruments also exposes countries to exchange rate and rollover risks. The changes in debt instruments, increased use of complex loan terms and the variety of Africa's creditors would also complicate debt management and restructuring. These have implications for debt governance and the future of ODA in achieving the SDGs and inclusive green growth transitions in Africa post-Covid-19.

The commercial loans often come with higher interest rates, shorter terms, and lack of policy conditionalities that ultimately make these loans far more expensive and heightens the risk of default. When countries are constrained to use short-term resources to finance long-term investments, the risk of default can increase. In addition to further squeezing the already constrained fiscal positions of African countries, the governance challenges associated with commercial loans have significant implications for debt productivity and debt sustainability. The type and quality of debt is therefore as important as the size of debt.

Indeed, there is need for harmonization of public debt in African countries to better evaluate the risks, identify tools for optimization and restructuring. There are challenges with “hidden debt” in some countries that need to be addressed. This issue needs to be addressed to ensure a structured and transparent approach to dealing with Africa’s debt challenges in a sustainable manner.

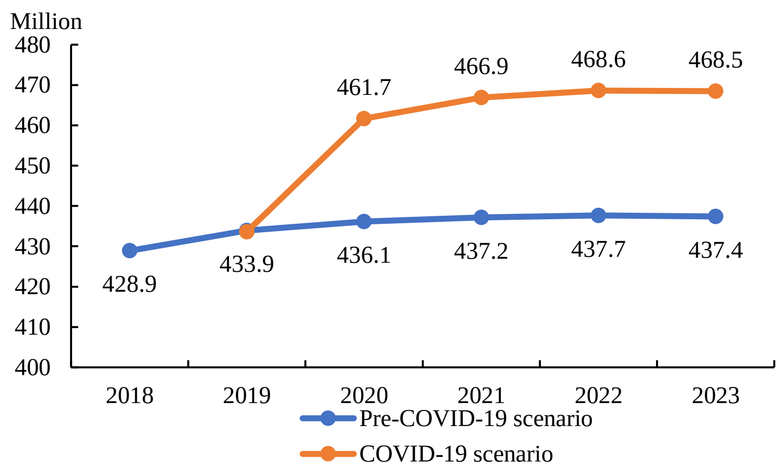
There is need for a critical review of public finance management practices in Africa and globally to inform specific actions to enhance fiscal resilience in future. In this regard, the African Development Bank Group approved two key strategies including - a Strategy for Economic Governance in Africa (SEGA) and a Capacity Development Strategy (CDS) for the period 2021 – 2025; and a Multidimensional Action Plan for the Management and Mitigation of Debt Distress Risks in Africa (2021–2023). These instruments set out clear frameworks for the Bank’s interventions to (i) support prudent economic governance, (ii) boost domestic resource mobilization, (iii) address leakages including illicit financial flows (IFFs); (vi) strengthen institutional capacity for macro-economic policy and public finance management; (v) and accelerate technical assistance to facilitate bankable project development and project portfolio management in African countries. The Debt Action Plan consolidates the Bank’s efforts in addressing the debt distress in African countries. Through these instruments, the Bank will continue to deepen its partnerships with the World Bank, IMF, and other institutions to accelerate its interventions on public finance management in Africa. The Bank is currently engaging with stakeholders to elaborate a proposal for the establishment of a Public Finance Management Academy (PFMA) for Africa. The PFMA is designed to accelerate training, technical assistance, and policy dialogue on the subject. These interventions will support African countries to build back more resilient economies.

The Bank is also actively engaging its member countries to optimise the benefits of the temporary measures made available through the Debt Service Suspension Initiative (DSSI), the Common Framework for Debt Treatments beyond the DSSI, the allocation of IMF Special Drawing Rights (SDRs), and the recent upside movement in commodity prices and increasing demand due to strengthening global economic activity. These are all positive and encouraging developments. However, the recent emergence of new variants of the virus with multiple mutations raise renewed concerns about the risk of deceleration in growth.

5. The Covid-19 pandemic has significantly impacted lives and livelihoods in African countries

Specifically, progress in poverty reduction and job creation, prior to the pandemic, has been negatively impacted by the pandemic. An estimated 26 million Africans were pushed into extreme poverty in 2020; with an additional 30 million expected in 2021 (Figure 6).

Figure 6: Estimates of increase in the number of people in extreme poverty in Africa 2018 - 2023



Source: African Development Bank estimates based on World Bank PovcalNet datasets, AfDB Statistics, IMF's World Economic Outlook (WEO) October 2019 edition, and population projections by United Nations Population Division.

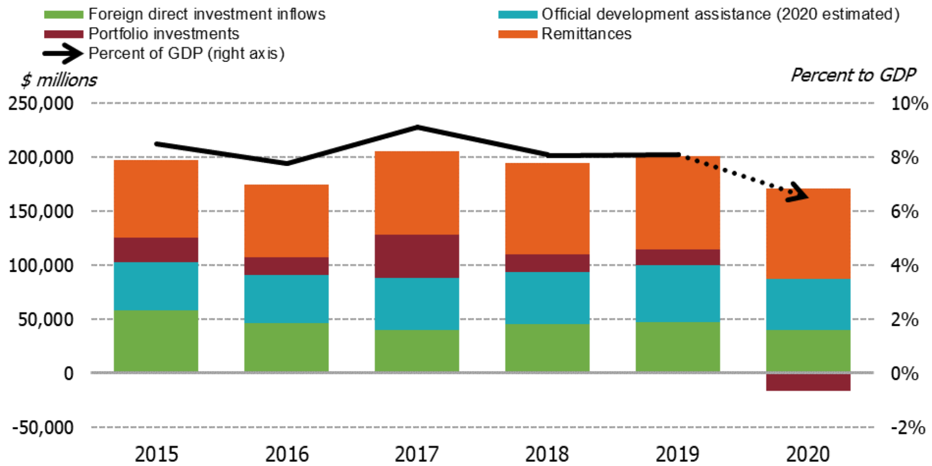
About 30 million jobs were lost in African countries in 2020. In general, workers in the informal sector, women and youths were the hardest hit by Covid-19 impacts. School closures are already eroding the positive trends in education over the past decade. The pandemic has also stretched health systems to their limits and created secondary health care crisis in countries. Inequality is likely to increase, and school closures could have long-lasting consequences for human capital accumulation and productivity growth.

6. The pandemic has also impacted financial flows into Africa, negatively

Financial inflows in African countries declined overall to 5.86% of GDP in 2020 from 6.97% in 2019 (Figure 7).

Foreign Direct Investments (FDI) declined by 15.6% (from $47.1 billion in 2019 to $39.8 billion in 2020). Official Development Assistance (ODA) declined by 10% (from $52.88 billion in 2019 to $47.59 billion in 2020), and portfolio investments dropped 212% (from a net inflow of $14.3 billion in 2019 to a net outflow of $16 billion in 2020).

Figure 7: External financial flows to Africa, 2015-2020



Source: African Development Bank Statistics

Remittances which are key sources of financing for poverty alleviation and consumption smoothing in Africa declined by between 6 – 8.7% during the year. These decreases in affordable financing for development (grants, concessional loans, and low-cost financing from the Paris Club Creditors) has driven an increase in debt owed to private creditors and non-Paris Club Creditors during the past decade. The share of debt owed to private creditors has more than doubled, from 17% in 2000 to 39% in 2019.

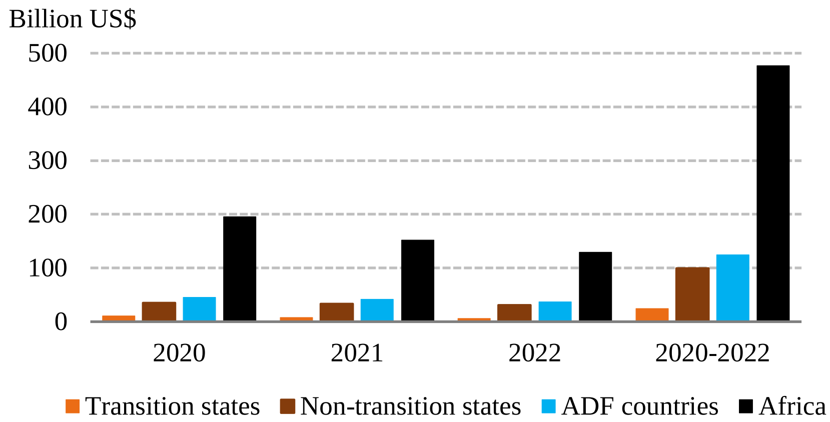
7. Financing needs for economic recovery post-Covid-19 in African countries has increased significantly

The pandemic has prompted a surge in government financing needs in African countries as governments spend more to address the socio-economic consequences of the pandemic. The African Development Bank estimates that African governments will need some $484 billion within the next three years to address the socio-economic impacts of the pandemic and support economic recovery alone (Figure 8).

The gross financing needs to address the impacts of the pandemic as a percentage of GDP vary widely across African countries in 2021, in some cases exceeding the critical threshold of 15% of GDP[7].

[7] The African Development Fund (ADF) eligible countries as of January 2020 include Benin, Burkina Faso, Burundi, Cameroon, Central African Rep., Chad, Comoros, Congo DRC, Côte d'Ivoire, Djibouti, Eritrea, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, Somalia, South Sudan, Sudan, Tanzania, Togo, Uganda, Zambia, Zimbabwe. These are countries facing different forms of fragilities in Africa and hence are eligible to receive grants and concessional loans from the African Development Fund (ADF) which is part of the African Development Bank Group, together with the African Development Bank (AfDB) and the Nigerian Trust Fund (NTF).

Figure 8: Financing needs (US$) required to address Covid-19

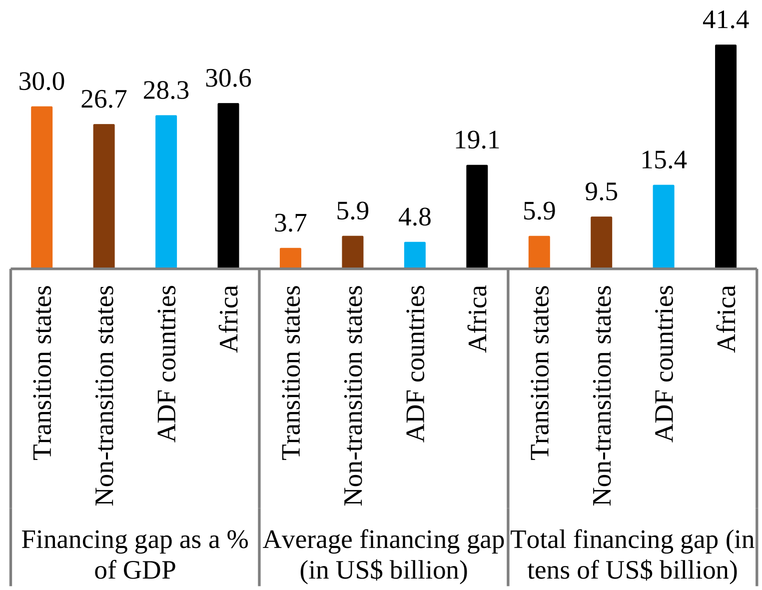


Source: African Development Bank Statistics

8. Financing requirements to end extreme poverty in African countries by 2030 is significantly high

Annual financing gap to end extreme poverty by 2030 is estimated at 30.6% of GDP, or US$ 19.1 billion on average per country between 2021-2030 (Figure 9).

Figure 9: Financing gap (as a % of GDP in US$ billion) to end extreme poverty in Africa countries by 2030



Source: African Development Bank Statistics

For Africa's low-income countries (also classified as African Development Fund (ADF) eligible countries), the annual financing gap to end extreme poverty by 2030 is estimated at 28.3% of GDP, corresponding to US$ 4.8 billion per ADF country between 2021 and 2030. Achieving SDG goal 1 in the transition and non-transition states will require about 30% of GDP and 27% of GDP, respectively. To meet the 3-percent poverty target, Africa will need to grow on average by about 12.1% per year between 2021 and 2030; and receive about 53.6% of GDP in public investments annually. For the ADF countries, they will need to grow on average by about 15% per year between 2021 and 2030; and received about 63% of GDP in public investments annually.

If one juxtaposes these requirements with the statistics on the impacts of Covid-19 on GDP growth rates and macro-economic fundamentals in African countries in 2020 alone, the magnitude of their fiscal challenges become rather obvious.

In addition, other global commons challenges such as climate change is expected to worsen the fiscal challenges in African countries in the medium term, if appropriate and urgent actions are not taken. A recent report published by McKinsey & Company in January 2022, estimates that global capital spending on physical assets for energy and land-use systems in the net-zero transition between 2021 and 2050 would amount to about $275 trillion, or $9.2 trillion per year on average, an annual increase of as much as $3.5 trillion from today. According to the report, the spending would be front-loaded, rising from 6.8% of GDP today to as much as 8.8% of GDP between 2026 and 2030 before falling. These spending requirements are large, and the sources of financing has yet to be established. The role of prudent public finance management in the post-Covid-19, climate-compliant and sustainable world cannot therefore be overemphasised.

Beyond the physical climate risks which countries require resources to adapt to; the African countries' sovereign risk ratings could worsen due to climate risks and impacts. This, in turn, increases the cost of capital and the debt repayment burden for countries.

The pandemic could lead to other pandemics – youth unemployment, extreme poverty, increased climate risks, and continued health pandemics, etc. These will deepen social fragilities, exacerbate unskilled rural-urban and international migration, and insecurity everywhere.

9. Implications for financing competing development objectives: poverty eradication versus other SDGs including green development and net zero transitions

Covid-19 has demonstrated our common future and the need for global action to address global commons problems in better ways than ever before. But economic recovery policies have come with risks: (a) deepened inequity between the rich and the poor countries; (b) unprecedented easing of fiscal and monetary policy expected to pose challenges for macro-economic policy management in the developing countries; (c) years of progress in globalization and associated benefits are now being questioned.

Other global commons challenges: climate change, biodiversity loss, water pollution, global security, etc., require continued attention. Public discourse on development financing is increasingly inclining towards greening the development finance architecture. This raises questions regarding potential trade-offs and/or co-benefits among the competing development objectives including poverty eradication and green transition in key sectors. Governments are faced with the need to finance the immediate development objectives of alleviating poverty and serving the basic needs of citizens today and financing green transitions for sustainable development tomorrow. Urgent global action is required to find more innovative ways of ensuring a more inclusive and sustainable recovery, long-term stabilization of the global economy and future resilience. Times of crisis present opportunities for innovation. We must not allow the Covid crisis to be wasted by going back to business as usual.