October, 2022

REIMAGINING THE INTERNATIONAL FINANCE SYSTEM FOR AFRICA

IMF and World Bank Annual Meetings Policy Brief

The Reason for this Policy Brief

This policy brief is intended to support African governments and policymakers, as well as development practitioners, in delivering clear positions on development finance issues at the IMF and World Bank Annual Meetings (henceforth, "Annuals"), to meet Africa's long-term development needs. The content of the policy brief takes as its objective the continent's robust continental-wide vision to utilise growth for poverty elimination to achieve the UN SDGs by 2030, as well as Agenda 2063.

In this respect, it provides the basis for further steps required to increase African agency in the international financial system (IFS) by centering borrower's perspectives – rather than the status-quo, creditor-centric approach.

In particular, the brief starts from the realization that pledges of more finance without reform is not sufficient. Many global challenges are not being tackled because of global coordination failures, not funds, and existing funds often reinforce inequities. For instance, when it comes to vaccines, the African Union's (AU) Africa envoy Strive Masiwiya was very clear that the inequitable vaccine challenges African countries faced were due to wealthier countries hoarding, rather than a lack of finance per se.

REFORM AND INNOVATION

Two Key Drivers for African leaders at the Annual Meetings

Using this brief, African leaders will be better equipped to use the opportunity of the World Bank and IMF Annual meetings to improve the quality of the IFS to work for borrower country needs through proposing much-needed reforms to traditional methods combined with new, innovative approaches.

First, there is a need to reform existing mechanisms within the international financial system. Many mechanisms directly impede African countries' access to affordable external finance by enforcing poorly evidenced debt ceilings and increasing the cost of borrowing.

Second, there is a need for innovative and solution-focused proposals and mechanisms to deal with debt, financing and economic shocks, while also creating new avenues for massive scaling up of finance to meet Agenda 2063 and the SDGs on the continent.

This brief provides background for 6 specific proposals that fit under these two positions:

1. **Reforms to the IMF and World Bank's Debt Sustainability Analysis**
2. **Reform to Views and Principles of Responsible Sovereign Lending**
3. **Urgent SDR Reallocation through Regional Development Banks and existing Climate Funds**
4. **Multilateral Development Banks must scale their finance to align with the SDGs**
5. **Prioritize and Support Borrowers Coordination urgently**
6. **Create a Permanent Emergency Debt Suspension Mechanism**

BACKGROUND

What Do the Annual Meetings Mean for African Countries Access to Development Finance?

The Annual Meetings bring together key stakeholders in the IFS to discuss key topics concerning the global economy which informs major policy initiatives going forward. Therefore, these Annuals are extremely important for African countries who must borrow to fuel their development to meet the UN SDGs and Agenda 2063.

The continent itself is also crucial to a thriving global economy, therefore representation by African leaders is crucial. Indeed, the continent's population is projected to reach 2.5 billion by 2050, out of which 1 billion are expected to be below 25 years – meaning a young and productive workforce. Further, African countries are investing in infrastructure which will help their economies flourish. Improved infrastructure has a direct positive impact on the economy, movement of goods and services and productivity. With the African Continental Free Trade Area (AfCFTA), infrastructure will increase trade, with the AfCFTA estimated to increase African exports by 35% and intra-African exports by 109% by 2035.

Yet, despite African countries proactively seeking external finance to fund development, there are still significant infrastructure gaps, with the AfDB estimating that Africa's infrastructure financing needs stand at US$130–170 billion per annum, with a financing gap ranging between US$68–US$108 billion. However, due to the IFS being primarily a creditor-centric system, African countries are often locked out of fair, concessional borrowing, meaning access to capital is restricted and costly. Indeed, even throughout the COVID-19 pandemic, the IFS has failed to provide adequate financing and support to the continent – and has only provided temporary, short-lived relief.

Therefore, using this COVID-19 "moment" African leaders and development practitioners must push for essential reforms to traditional mechanisms which favor creditors over borrowers, as well as put forward innovative proposals to increase borrower country agency and representation in the IFS.

KEY POLICY ISSUE 1

Reforming Existing Mechanisms in the International Financial System

Both the African Union’s Agenda 2063 and the UN SDGs require extensive financing, however, this capital cannot be sourced solely by African financial institutions, nor by internal resources, and requires external borrowing.

Yet, the IFS overwhelmingly prioritizes creditors, whether this is through surveillance and conditionalities on borrowing countries or by hiking up interest rates on debt.

Therefore, we provide **two Action Calls** that African leaders and development practitioners can make at the Annuals to reform the IFS to work in borrowing countries' favor.

Action Call 1: Reforms to the IMF and World Bank’s Debt Sustainability Analysis

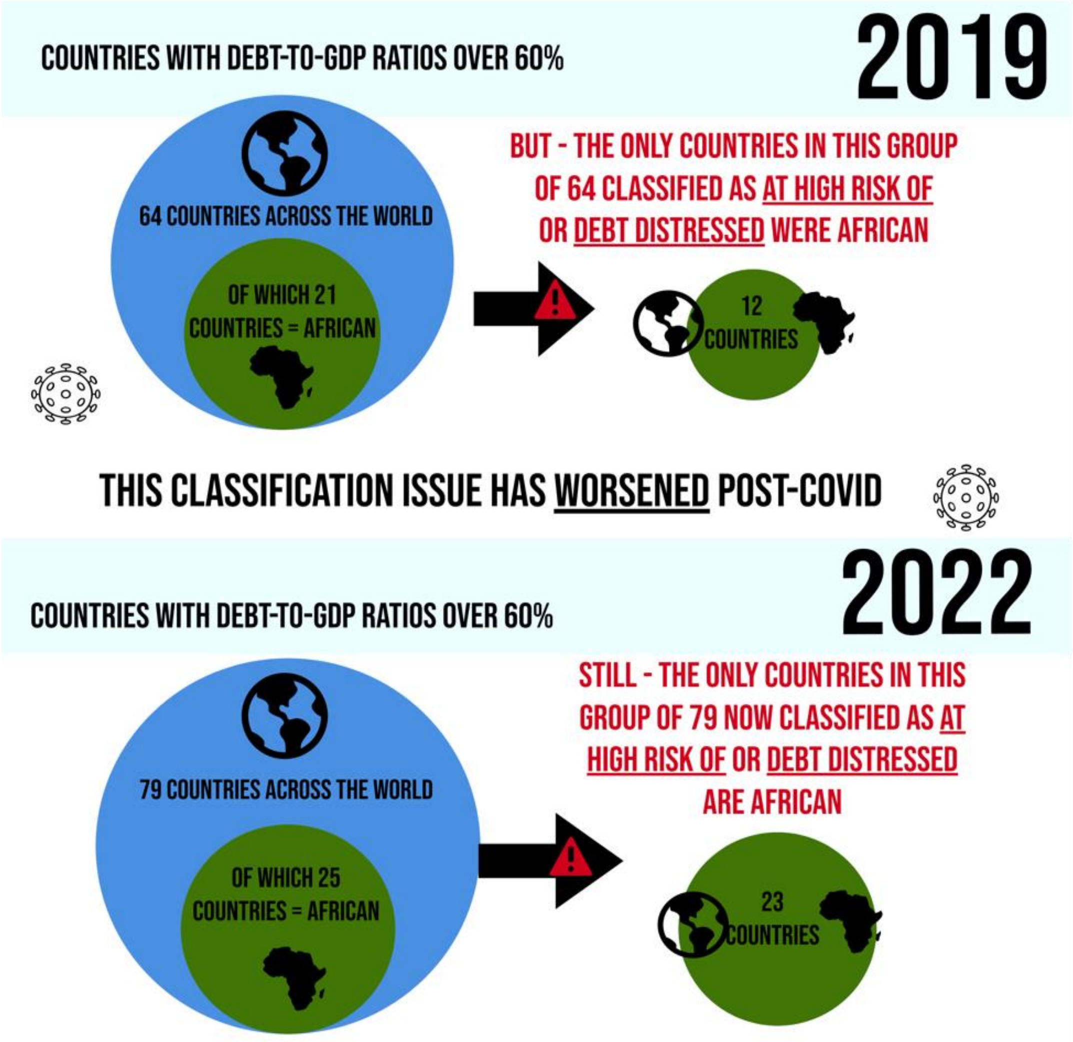
Action Call 2: Reform to Views and Principles of Responsible Sovereign Lending

KEY POLICY ISSUE 1

ACTION CALL 1: Reforms to the IMF and World Bank's Debt Sustainability Analysis

Background: The IMF and World Bank Debt Sustainability Analysis's (DSA) main objective is to monitor low-income countries' debt levels by classing them as either low, moderate, high or at risk of debt distress, with the majority of African countries falling in the last two categories.

However, as the graphic below illustrates, there is serious bias in the DSA. In 2019, 64 countries across the world had debt to GDP ratios over 60%, a third of whom were African. However, all 12 of those who were classified as debt distressed in this group of 64 were African. This classification issue has worsened post-COVID. Now, 79 countries have debt to GDP ratios over 60%, a third of whom are still African. However, there are now 23 of the 79 that are classified as debt distressed, and still all 23 are African.



The analysis has financial consequences. Those who find themselves rated as high risk or in debt distress results in an **"African Risk Premium"** making borrowing more costly when countries apply for commercial credit as well as discouraging potential investors. Indeed, a 2015 study found that this premium saw African countries paying 2.9 per cent higher on bonds than the rest of the world. Yet, the evidence for thresholds used in the DSA is thin. A recent meta-analysis published in the Journal of Economic Perspectives examined 816 estimates and found no uniform public-debt-to-GDP threshold that had an effect on growth. Put simply, many middle- and high-income countries have developed with much higher external debt to GDP thresholds and lower export to GDP ratios imposed by the DSA. Therefore, imposing restrictive thresholds over African and other low- and middle-income countries must be questioned.

The DSA directly hinders Africa's potential to attract lending, private investment and other forms of capital at reasonable rates. The Dakar Action plan convened by the World Bank in 2022 noted African leaders stating, "We believe that public sector assets and liabilities should now form the basis of country-specific risk analysis beyond traditional debt sustainability analysis models". This is useful as it can enable a broader analysis of risk such as examination of climate change risks, but is not sufficient, and could even exacerbate the DSA problems if not well managed (e.g., to classify countries as "vulnerable" even when certain thresholds have not been reached).

Specific Proposal(s):

1. **The DSA should be uniformly applied to all countries**. The DSA currently conveys the impression that African and other low- and middle-income countries must be surveilled financially as though they cannot make excellent financial decisions. Yet the 2008 financial crisis and multiple other events have shown, high-income countries need as much surveillance and pose major domestic and international risks. On the other side, COVID-19 has shown that African countries can handle themselves much better than given credit for. The continent had fewer death rates and even implemented COVID-19 measures before a single case was reported all while controlling the spread of the disease.

2. **The DSA should track the "positives" of debt by focusing on the quality of debt rather than just its quantity and adjust thresholds on this basis.** Debt can fund growth-inducing projects. For example, African governments often borrow for capital expenditure such as infrastructure projects, including projects in energy, railway, and roads, all of which have growth-inducing spin-off effects such as creating jobs and incomes, enhancing productivity, facilitating regional and international trade and developing value and supply chains. These "endogenous growth" effects should be accounted for in the DSA.

3. **The DSA should account for the "gap" countries have between their existing capital needs and the capital needs to achieve the SDGs**. Right now, there is no way to adjust DSAs based on need. The SDGs and Agenda 2063 cannot be met without increased spending and sufficient access to concessional finance to do so.

ACTION CALL 2: Reform to Views and Principles of Responsible Sovereign Lending

Background: Current Sovereign Lending Principles (such as UNCTAD principles) intend to "promote responsible sovereign lending and borrowing practices". Countries such as Japan have emphasized this recently when making pledges to African countries – for instance with references to "unfair and opaque development finance." However, the principles both unduly favor a creditors perspective by placing significant, additional responsibilities on borrower countries (such as transparency or climate-friendly), while overlooking certain key issues in creditor behavior.

This approach can be seen in several cases. First, many principles are based on traditional approaches to lending and must be adapted to account for new creditors and their approaches to lending, such as China. For example, loans from traditional lenders often come with conditionalities to put pressure on African governments to make internal policy changes which may not be in their best interest. This has been common practice in IMF loans and debt restructuring, as well as in conditions from other bilateral lenders. Principles should emphasize actual best approaches by creditors, not approaches preferred by certain creditors.

Similarly, many principles fail to account for "good debt" which can provide growth-inducing capital assets, while at the same time creating additional, narrowing requirements for borrowers to fit their loan requests into (e.g., loans must be climate-friendly, etc.) and or requiring certain assessments and standards that go beyond what countries (often democratically elected) have decided to implement. While these are laudable ambitions, it doesn't account for the fact that countries need more finance to meet new goals, and again can conflict with national sovereignty. Principles should aim to benefit low- and middle-income or African countries, supporting them to accumulate debt to fund development, avoiding them being branded as "irresponsible borrowers".

Specific Proposal(s):

1. **Lending Principles should encourage creditors to respect the principles of non-intervention** during sovereign lending, including managing the deployment of environmental and social safeguards in such a way to avoid intervention.

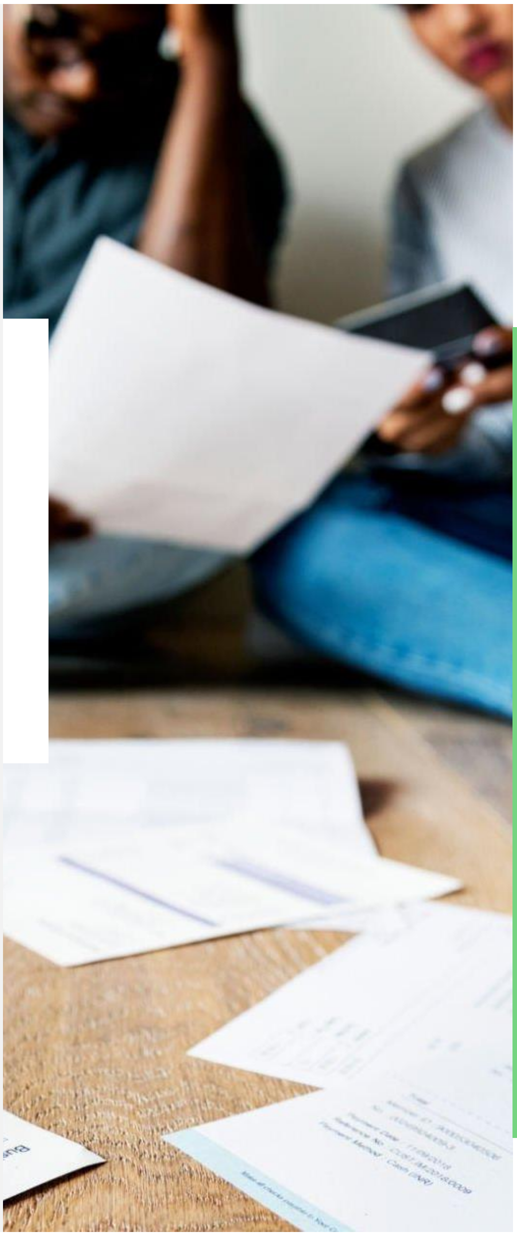
2. **Lending Principles should encourage creditors to provide more finance for growth-inducing debt**, and reward creditor behavior such as "additionality" – for example extra climate finance beyond aid.

Such reforms can support and be determined through borrower coordination to negotiate the best loan deals, as well as debt restructuring agreements (see Policy Issue 2, Action Call 3).

KEY POLICY ISSUE 2

Innovative Debt Solutions

As the response to COVID-19 has highlighted, there is an urgent need for new innovative and solution-focused mechanisms that center borrowers' perspectives. Using this COVID-19 “moment”, there are a number of African-led proposals for ongoing policies, such as SDRs, as well as mechanisms to coordinate and support borrowers in both securing external finance and in debt negotiations which can be reiterated going forwards.



ACTION CALL 3: Urgent SDR Reallocation through Regional Development Banks and existing Climate Funds

Background: Special Drawing Rights (SDRs) are an international reserve asset created by the IMF. In August 2021, the IMF allocated USD 650 billion SDRs, the largest allocation to date, to support the economic recovery of countries post-pandemic and to build global reserves. SDRs are allocated in proportion to a country's IMF quota shares, which are determined based on a country's position in the world economy, meaning that developing countries receive a very small portion.

Indeed, Africa received only 5% (USD 33 billion) of the USD 650 billion allocations, while the G20 countries received USD 442.8 billion. Yet, to date, African countries have spent in total over USD 200 billion on the economic and social response to COVID19, reaching over 100 million people through these funds, and therefore avoiding poverty.

Hence, due to the initially poorly distributed allocation of SDRs, there has been a great push by the international community for developed countries to reallocate their SDRs to the continent through bilateral transfers as well as through prescribed holders of SDRs – i.e. the IMF itself and a number of other multilateral and regional banks .

To date, there have been some, but very limited pledges by countries to reallocate their SDRs. For example, the G7 and G20 pledged to reallocate USD 100 billion to a 'Global New Deal' for Africa as discussed by French President, Emmanuel Macron and several African leaders. At the November 2021 Forum on China Africa Cooperation, China pledged USD 10 billion reallocated SDRs to African countries. In total, G7 and G20 countries have only committed USD 56 billion, with no disbursement to date.

Recently, the IMF created the Resilience and Sustainability Trust (RST) to channel SDRs through the IMF to fund global challenges such as climate change or global health. The RST is expected to be operational before the end of 2022, with an initial capital aimed at US 50 billion. The IMF has also proposed that SDRs could be channeled through its existing Poverty Reduction and Growth Trust (PRGT).

However, the RST and PGRT are not necessarily the answer for African countries for several reasons.

First, for climate change in particular (as well as global health) there are already existing, cash-strapped funds.

The Green Climate Fund (GCF) in particular, has been in place for over ten years and has a hard-won, equal developing and developed country decision-making structure. It also has the World Bank as an arms-length trustee, which means SDRs can also be channeled into it. However, since March 2020, it has only been able to disburse USD 8.8bn to African countries due to a lack of finance. The GCF – and its sister project, the Adaptation Fund (AF), which also has the World Bank as trustee – would be a perfect existing vehicle for new SDRs.

Second, regional – not global – funds are vital, especially for Africa. Every other region aside from Africa – from the Caribbean to Asia – has its own lender of last resort, their version of the IMF.

There are plans for a new African Monetary Fund (AMF), but those plans have, to date, only received ratification by 12 African countries. Committing to channel SDRs to an AMF would quickly incentivize more countries to join. In the meantime, the African Development Bank (AfDB) is already approved to hold SDRs.

Having faced constraints in its lending capacity before COVID-19, the AfDB managed to approve projects close to $6bn worth since the start of the pandemic, and has been at the forefront of the discussions around rechanneling SDRs through multilateral banks and has on multiple occasions argued that the Bank will be able to leverage SDRs channeled through the Bank up to three to four times . For instance, a USD10 billion reallocation to the Bank will be leveraged to USD 40 billion for African economies. As an African-owned and led institution with a strong reputation for financing much needed regional infrastructure projects around the continent and helping economies grow, adding SDRs to the Banks portfolio will go a long way in meeting continental goals such as Agenda 2063.

Last but not least, for African borrowers, it is not possible to earmark RST or PGRT funds for African countries, while accessing the RST requires an IMF program, which can provide an opportunity for the IMF to create policy conditions (e.g. tax reform, currency reform, etc.).

Given that SDRs were meant to be provided as a fiscal injection to support countries to respond to COVID19, any policy conditionality does not seem appropriate, and indeed, given experience of the past, could exacerbate rather than reduce poverty.

Specific Proposal(s):

1. **SDRs to African countries should be urgently and primarily channeled through the African Development Bank** – as a mix of concessional and commercial loans.

2. **SDRs to global challenges such as climate change should be channeled to regional banks** (e.g., AfDB) or existing climate funds with balanced global representation such as GCF and AF.

3. **Any further new SDR allocation should have a different model of distribution to avoid the inequities** that were created by the 650 billion allocation.

ACTION CALL 4: Multilateral Development Banks must scale their finance to align with the SDGs

Background: In 2015 at the Third International Conference on Financing for Development, heads of state and government adopted the Addis Ababa Action Plan on Financing for Development (AAAA). The Action Plan states that Development Banks should;

> Update and develop their policies in support of the post-2015 development agenda, including the sustainable development goals" and that "multilateral development finance institutions [should] establish a process to examine their own role, scale and functioning to enable them to adapt and be fully responsive to the sustainable development agenda.

However, since the adoption of the AAAA, there has not been increased concessionally or a significant increase in volumes of lending with minimal coordination amongst MDBs and a lack of understanding or consistency on the meaning of SDG alignment. Development Finance is a scarce resource and public and private financing needs to be in line with the SDGs. Several countries, particularly developing countries, are working towards aligning their national agendas and development objectives with the SDGs. Development banks must be supporting these countries with this goal by providing the necessary concessional financing needed to meet the SDGs.

There are numerous ways in which Development Banks can meet AAAA commitments.

A key means would be following the recommendations of an independent report commissioned by the G20 and led by an African – Frannie Léautier – which concluded that the World Bank – as well as other MDBs - have been too cautious about risk inter alia due to being too close to and focusing too much on views of private credit ratings agencies.

The report implies the World Bank and MDBs should have been lending more and therefore trying to reduce more poverty, over years that cannot be reclaimed. This can and should be corrected as soon as possible. Another means would be designing metrics to measure progress and conducting independent annual reviews to measure progress on SDG alignment.

Furthermore, as senior leadership within MDBs play a vital role in shifting the priorities of the banks, there needs to be a great push for great diversity and new perspectives. This will address challenges of “group think” in the organization, which have significant consequences for African countries, such as the reality is that the World Bank has been shying away from providing finance for much needed, efficient new infrastructure in African countries for decades.

While the Bank continues to provide loans to expand road networks, it has not financed a new rail route since 2002 on the continent, despite requests to do so. It has financed metro systems in Latin America and Asia, but African lending has been confined to BRTs, leaving countries such as Kenya or Senegal to seek support from bilateral donors such as China and France.

Specific Proposal(s):

1. **MDBs (especially the World Bank) should take steps to reform their capital adequacy frameworks** within one year so as to release urgently needed finance to meet the SDGs.

2. **The diversity of senior leadership, staff and consultants at all levels in International Financial Institutions should reflect the regions they serve rather than shareholders**. In the case of the World Bank for example, this would mean increasing targets for African representation well beyond current targets of around 12.5%, etc.

ACTION CALL 5: Prioritize and Support Borrowers Coordination urgently

Background: African states borrow for various reasons such as infrastructure development and sometimes for recurring expenditure. The increased social spending required from the COVID-19 pandemic combined with dampened economic activity has led a handful of African countries, such as Zambia, to default on loans leading to debt restructuring talks with creditors and IMF programmes.

During this process, creditors have organised through "clubs" or "committees", such as the Paris Club, to coordinate with each other on the terms of restructuring. These creditor coordination arrangements are not new. They were used for the HPIC initiative, and most excluded the borrower from negotiations. After presentation of the case, the borrower exits, and a French representative conducts shuttle diplomacy to inform the borrower of the outcome. It is an antiquated, colonial arrangement.

Calls have been made for China to join these arrangements, and after requests by borrowers (such as Zambia) China has joined. The prevailing narrative that since China is "outside", the country does not provide debt relief or restructuring, and that in turn, this impairs African countries' economic stability. However, most African policymakers know this inference is factually incorrect. China does engage in debt relief as well as restructuring. At Development Reimagined, we have calculated that over the period 2000-2018, China cancelled debt of at least 20 African countries, equivalent to 1.5% of all loans taken out across Africa from China, and in some cases such as Zambia more than other bilateral lenders. Analysis by the Rhodium Group in 2019 found 40 cases in which China had renegotiated or restructured debts, including of several African countries.

Indeed, some restructuring agreements have included projects and loan cancellations to create fiscal space. For example, Zambia's IMF deal will see Zambia shift its spending priorities to recurrent expenditures with a reduction in spending on capital expenditure, such as growth-inducing infrastructure typically financed by the Chinese. However, countries such as Ethiopia and Chad are yet to complete their debt restructuring talks, so there is an opportunity for these countries to learn from Zambia's IMF deal and coordinate with each other for better terms.

KEY POLICY ISSUE 2

China is not a perfect lender - much can be done to improve the terms and conditions of Chinese loans and even its debt relief and restructurings for African countries. There is a wide disparity in treatment and volumes. But this does not indicate creditors should coordinate. It suggests borrowers should coordinate – to exchange experience and be in the room together. Indeed, that is a model borrowers could consider with respect to all creditors – the Paris Club, the IMF, World Bank and China included.

There is an urgent need to increase Borrower Coordination for countries to share key information. Such coordination can be achieved through a Borrowers Club, which can exist across a spectrum of different forms of coordination to enhance Borrower agency in the IFS. For example, the Club could negotiate and share information on contract terms by different lenders and discuss how to enhance Borrower agency into such terms. Another example is that borrowers could use the Club to secure new lending, by using each other's growth prospects as collateral thereby reducing risk. Key aspects of the Club are highlighted in the text box below.

A Borrower's Club would be highly beneficial to Africa in more ways than one. African governments will have access to credit that will bolster project initiation and continuity as there is availability of low-interest loans. Coordination among African governments will improve while also providing platforms to share ideas and experiences. As for the creditors, they benefit from pooling their resources which means the risks are lower. Additionally, the creditors receive regular payments and evaluation reports from the independent trustee reducing foul play. Given the key stakeholders in attendance at Annuals, it is a strong opportunity for African leaders and development practitioners to raise the need for borrower coordination in the IFS.

THE BORROWER'S CLUB:

- Borrowers meet regularly to determine priority projects for the members, based on clear eligibility criteria;
- Borrowers appoint a representative(s) to interact with creditors and this can be on a rotational basis;
- Borrowers will appoint an independent trustee based on certain criteria such as its capital or reputation;
- Borrowers as quickly as possible begin to make equal small, low-interest regular payments to an independent trustee;
- The repayments are designed to be small with low-interest rates for ease of payment while also sufficient to build in a "cushion" for temporary collateral;
- Borrowers deliver their projects independently, monitor and evaluate results and meet regularly to keep each other accountable for progress and to agree on new projects;
- If a project is delayed, faces challenges or a borrower faces repayment challenges, the borrower committee must agree for the cushion to be made available to support temporarily;
- Borrowers in arrears do not get more loans.

Specific Proposal(s):

1. **African (and other) borrowers should as a priority work together (and receive support) to convene and coordinate** together on their own, share experience and negotiation practices to get more out of the financial system, including the IFIs, emerging economies such as China, the Paris Club and private sector lenders.

2. **MDBs should consider how to reorient to introduce or become "borrowers clubs"** to enable the poorest countries to access much needed finance to meet the SDGs.

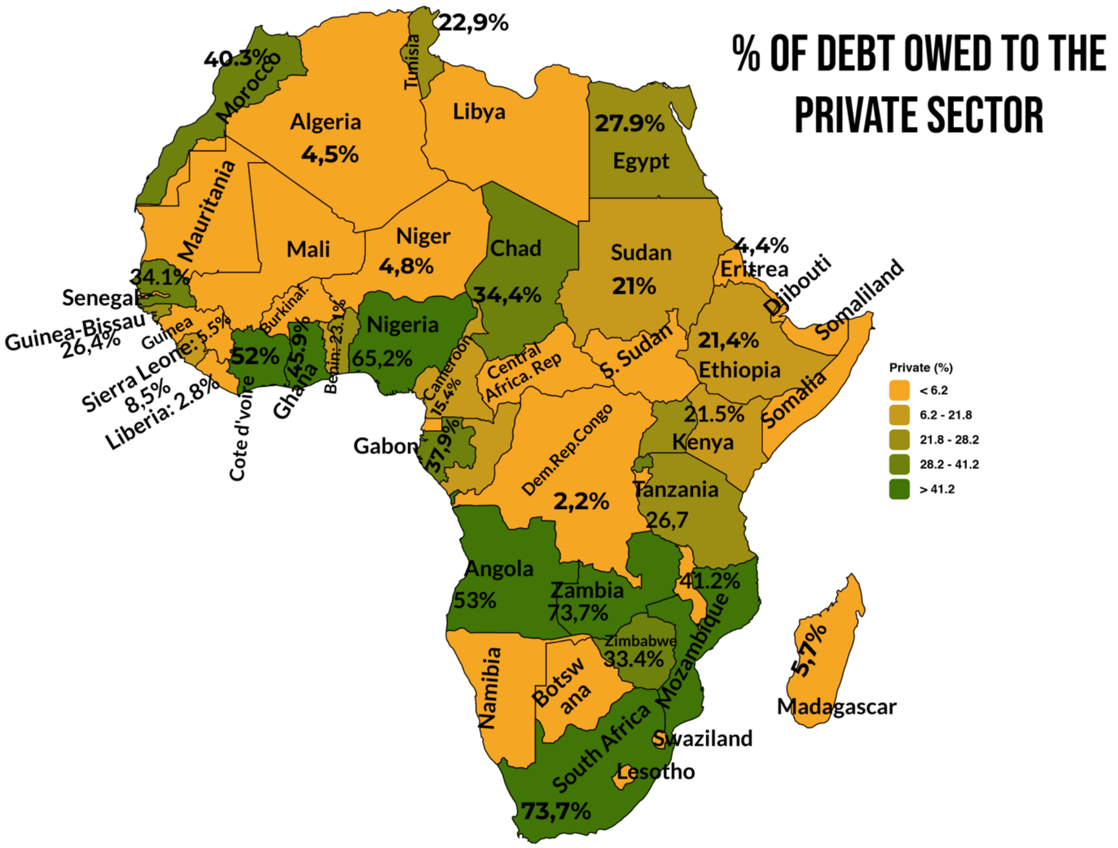
KEY POLICY ISSUE 2

ACTION CALL 6: Create a Permanent Emergency Debt Suspension Mechanism

Background: In response to the COVID-19 pandemic, the World Bank and IMF implemented the Debt Service Suspension Initiative (DSSI). Between May 2020 and December 2021, the DSSI suspended USD 12.9 billion in debt-service payments for borrowers from bilateral creditors. Although the DSSI did not cancel debt, it did provide essential fiscal "breathing room" for countries which enabled them to finance socio-economic protection measures.

However, multilateral and private creditors – who often account for significantly more debt repayments than bilateral creditors - did not participate in the DSSI, resulting in many African countries continuing to repay costly debt service with high-interest rates whilst financing COVID-19 protection measures alongside dampened economic activity.

This matters for African countries. As an example, the graphic below shows the percentage of debt owed by African countries to the private sector. It is not insignificant, especially for larger economies.



KEY POLICY ISSUE 2

Specific Proposal(s):

1. **The Bridgetown Agenda, as proposed by Her Excellency Mia Mottley, which urges disaster risk clauses to be included within future loan contracts should be essential in all contracts going forward**. This clause will temporarily reduce interest rate payments on debt during periods of disaster and crisis to enable essential fiscal space for countries. The agenda also has a further three key aspects, including i) long-term and emergency IMF concessional funding for development for the next 30 years, ii) expand MDBs lending capacity by $1 trillion with investment in climate resilience, iii) mobilise $3-4 trillion in carbon-cutting projects.

2. **A permanent emergency debt suspension mechanism including all creditors should be defined, designed and permanently established to give fiscal space to all low-middle income countries that may face national, regional or global shocks in the future**. This would also eliminate the need for repeated (inequitable) SDR allocations.