INTERNATIONAL MONETARY FUND

May 12, 2021

BACKGROUND NOTE FOR INTERNATIONAL FINANCING SUMMIT FOR AFRICA HIGH-LEVEL EVENT[1]

The COVID-19 pandemic is exacting a massive human and economic toll on Africa, leading to its largest output drop on record. African countries took decisive policy actions to mitigate the impact of the crisis, while the international community provided a rapid response with unprecedented financial assistance, especially to support low-income countries (LICs). However, without significant additional financing and stepped up reforms, the recovery currently projected will still leave African countries far from their pre-COVID path of convergence with the income levels of advanced economies (AEs).

*The analysis suggests that between 2021-2025, additional financing to all African countries of around **$285 billion** is needed to step up the spending response to COVID—of which about US$135 billion would be required for LICs. Roughly doubling this financing to increase investment spending would boost growth and return the region to its income convergence path with AEs; half of this amount would be for LICs.*

Bold domestic reforms aimed at stronger revenue mobilization, governance, and expenditure management, scaled-up highly concessional financing, and facilitation of private capital inflows are the major sources of filling the gaps in African LICs.

Regarding African emerging market countries (EMs), accelerated reforms would need to play a key role in meeting additional financing needs, given already high public debt. Domestic revenue mobilization, expenditure reprioritization, governance reforms, and external private financing to the private sector would be critical to limit additional public borrowing. In parallel, reducing the role of the state in economic activity together with improving the business climate would enhance growth potential. IFIs are expected to play a supporting role, including in capacity development.

THE NEED FOR FINANCING

The pandemic threatens decades of progress on the convergence in income levels of African countries with AEs. A lack of fiscal space and limited scope for monetary policy support have constrained African countries' policy response to the pandemic, even for those with market access in normal times. As a result, Africa's development has been set back significantly, and the continent finds its income levels diverging from the rest of the world. There are also signs of long-lasting economic scarring from disruptions to investment, human capital formation and social development, reversing gains in poverty and inequality reduction. Although the growth outlook is improving, the path of the pandemic remains uncertain in the region, as several African countries

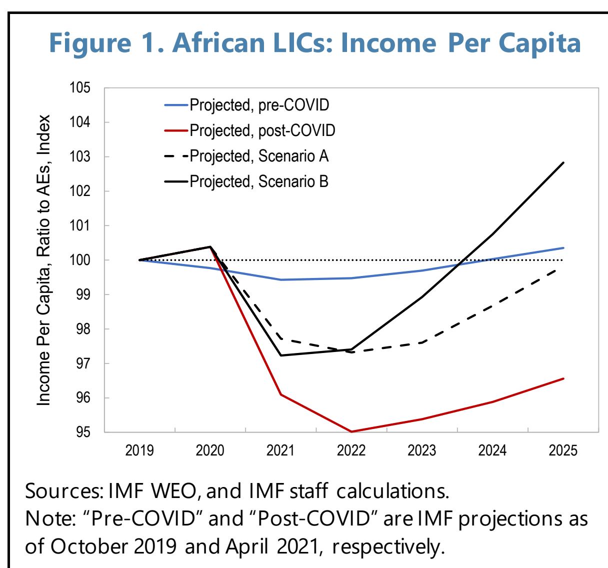
[1]Prepared by Staff of the International Monetary Fund. Does not necessarily reflect the views of the IMF Executive Board.

struggle with more virulent variants, and the prospects for broad-based vaccination remain uncertain.

International organizations and donors mobilized swiftly to support countries at this time of exceptional need. The G20-led Debt Service Suspension Initiative has eased financing constraints temporarily by up to about US$6 billion in 2020 and 2021H1 for participating African countries. The IMF has provided US$9 billion to African LICs and US$20 billion to African EMs since March 2020.[2] Moreover, 23 countries received debt relief of just over US$600 million on payments to the IMF under the CCRT. Multilateral development Banks (MDBs) and bilateral donors also provided significant financing. There have also been important efforts to extend vaccine availability in LICs through COVAX and a World Bank dedicated facility.

Additional financing is required to enable African economies to overcome the impact of the pandemic and return to the pre-pandemic income convergence path with AEs (Figure 1 and Table 1):

Figure 1. African LICs: Income Per Capita



Sources: IMF WEO, and IMF staff calculations.
Note: "Pre-COVID" and "Post-COVID" are IMF projections as of October 2019 and April 2021, respectively.

- **Scenario A** presents estimated additional financing needs to increase spending to counter the effects of COVID-related shocks, including to procure and administer vaccinations, to prevent permanent scarring of the economy, and to ensure adequate buffers (especially reserves).
- **Scenario B** presents the additional financing – on top of Scenario A – needed to increase investment spending (for both physical and human capital) enough to return African countries to the pre-COVID income convergence path with AEs by 2025.

Table 1. Africa: Additional Financing Needs, 2021–25
US$ Billions

	Scenario A		Scenario B	
	Lower bound	Upper bound	Lower bound	Upper bound
Africa	**284.6**	**485.9**	**518.1**	**719.4**
Low-income countries	137.0	205.3	267.1	335.4
Emerging market economies	147.6	280.6	251.0	384.0

Note: See Tables A1 and A2 for detail.

- Shocks to current accounts, fiscal deficits, capital flows, and financial conditions are also considered (for "upper bounds" of both scenarios).

[2]Including emergency financing, and new and existing programs.

ESTIMATING ADDITIONAL FINANCING NEEDS

A. Low-income countries[3]

The crisis has left African LICs with a pressing need to bolster crisis-related spending, strengthen external buffers, and boost investment. Additional spending needs for 2021-25 are estimated relative to the spending amounts embedded in the April 2021 WEO baseline projections.[4] As the WEO baseline projections are subject to uncertainty, the impact of adverse shocks to financial flows and current accounts is added to the estimates of additional financing needs to derive upper bounds of the estimates.

- **Scenario A.** The first two additional items are (i) additional public spending on social needs, health (including vaccines), and prevention of permanent scarring from the COVID pandemic, which is proxied by bringing COVID-related spending to the average of EMs; and (ii) additional resources to rebuild international reserves to three months of imports for all African LICs by 2025. ***The sum of these two components is US$137 billion and could rise to US$205 billion if downside shocks materialize.***

- **Scenario B.** Restoring income convergence for African LICs by 2025 (Figure 1) requires incremental investment spending, which is proxied by additional public expenditure needed to bring African LICs in line with the spending levels observed in EMs. Such measures include developing infrastructure for priority public services, enhancing climate resilience, and promoting digitalization. These expenditures are expected to boost growth in both the short and the medium to long term, accelerating income convergence. ***The increase in investment financing needs is estimated at US$130 billion, bringing total additional financing needs for African LICs to US$267 billion. This amount could rise to US$335 billion if downside shocks materialize.***

- These numbers have been assessed by IMF staff and adjusted based on country-specific factors, including debt levels and implementation capacity.

B. Emerging-market economies

African EMs' strong policy response has mitigated the impact of the pandemic while reducing their policy space. To mitigate the impact of COVID-19, African EMs relaxed their fiscal stance and eased monetary policy, while some countries allowed the exchange rate to adjust. After market conditions normalized, external bond issuances helped some countries finance their spending needs

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[3]LICs defined as those countries eligible for Poverty Reduction and Growth Trust facilities: 69 countries in Africa, Asia, and Latin America (IMF 2021).

[4]Additional financing needs have been estimated using the methodology set out in IMF (2021). For comparison, it used the same methodology to estimate that all LICs – including but not limited to African LICs – would need to deploy around US$200 billion up to 2025 to step up their response to the pandemic and an additional US$250 billion to accelerate their income convergence with advanced economies.

and rebuild some buffers. However, as most African EMs entered the crisis with high debt levels, their policy space to support the recovery in 2021 and beyond is constrained. Hence, net additional financing would need to be carefully balanced with debt sustainability considerations, and accelerated reforms will be needed to boost the recovery. Similar to African LICs, African EMs' additional spending needs for 2021-25 are estimated relative to the baseline projections embedded in the April 2021 WEO.

- **Scenario A**. Additional health and social spending needs are estimated at US$132 billion over 2021-2025 and additional resources to ensure a minimum level of external buffers, consistent with reaching 3 months of import cover for reserves by 2025 amount to US$16 billion. To maintain debt sustainability, however, significant reprioritization of non-priority spending will be needed to expand health and social spending (see below).

- **Scenario B**. To help restore income convergence, African EMs' additional investment needs are estimated around US$100 billion, aimed at gradually reaching the average EMs public and private investment to GDP. Given the size of the public sector in these countries and their high debt levels, private investment together with improved productivity will need to play a more prominent role in their income convergence (see below).

- These numbers have been assessed by IMF staff and adjusted based on country-specific factors, such as high public debt levels and limited fiscal space that constrain borrowing capacities.

FINANCING SOURCES

Both support from the international community and domestic reform efforts will have to play key roles in meeting these needs. IMF (2019) estimated that comprehensive reforms in African EMs and LICs might raise output by more than 7 percent over a six-year period on average, accelerating convergence with advanced economies.

The IMF will consider a formal proposal for a new general Special Drawing Rights (SDR) allocation of $650 billion. Based on quota shares, African countries would receive about $33 billion in SDR allocations under this proposal. Countries outside Africa with strong external positions could seek ways to voluntarily channel SDRs to support recovery efforts by African LICs and EMs by re-allocating their SDRs. Staff is currently exploring options for SDR channeling, including supporting additional concessional lending through the IMF's Poverty Reduction and Growth Trust (PRGT) and other options to support broader global public policy goals.

A. Low-income countries

Meeting the large-scale financing needed to offset the effects of the pandemic and accelerate income convergence in African LICs will require contributions from all potential sources. In the absence of external financing (both official and private), many countries may find themselves in a vicious circle—in which an external funding gap requires deeper fiscal consolidation, which then

ends up reducing near-term growth, adding to social tensions, increasing risk premiums, and limiting the authorities' ability to pursue productivity-boosting reform, thus leaving them trapped on a path of low growth and high debt.

- **African LICs will need to accelerate reforms.** These include mobilizing additional domestic revenue, enhancing the efficiency of public spending (especially health and investment), strengthening the financial sector, and improving governance and the business environment. These efforts would also help attract private capital inflows.

- **The IMF will need to step up its lending to LICs.** There is a pressing need to boost the PRGT's lending capacity through additional mobilization of loan and subsidy resources to finance more zero-interest lending, as well as implementation of LIC facilities reform to provide the Fund with greater flexibility to support LICs facing severe financing challenges. The IMF's catalytic role in helping to mobilize financing from other sources will continue to be important.

- **MDBs should boost their financial support for countries under stress.** This may require significant additional capital contributions and changes in lending practices. Importantly, MDB financing can come in the form of grants, which is best suited to helping certain LICs (below). Moreover, development of MDBs' instruments facilitating private financing (e.g., PPP, blended finance of major projects, guarantees, equity financing, co-financing of private projects etc.) could leverage public resources, provided fiscal governance frameworks are strengthened to limit fiscal risks.

- **Official Development Assistance (ODA) financing is another important source of financing that can be increased.** In 2020, ODA from members of the OECD Development Assistance Committee (DAC) amounted to 0.32 percent of gross national income (GNI) in these countries —well short of the UN target of 0.7 percent of GNI for advanced economies and up only a modest 4 percent in real terms from 2019 levels. Many donor countries face budgetary constraints, but ODA is a small component of budgetary outlays and can be increased as the large domestic fiscal stimulus provided to support economic activity is gradually being withdrawn.

- **The private sector is expected to play a growing role in financing development projects.** This process should be supported by macroeconomic stability, an improved business climate (see above), innovative MDBs' lending instruments (see above), and targeted government incentives (Eyraud and others, forthcoming).

- **Financing options—such as debt relief and grants—should take into account debt vulnerabilities that heightened significantly in some countries during the pandemic.** The region entered the COVID-19 crisis with less fiscal space than at the onset of the global financial crisis, with 20 countries either at high risk of debt distress, or already in distress in 2019. For those LICs with high debt:

- **Grant financing should play an increasing role.**

- **Debt relief under the DSSI and the G20 Common Framework are important sources of financing.** The agreed 6-month extension of the DSSI from all official creditors to end-2021 will provide additional liquidity support of up to US$5 billion. Moreover, countries requiring longer debt reprofiling or restructuring could benefit from debt relief under the Common Framework, which requires greater efforts to make it fully operational.

- **Capacity development (CD) efforts should be stepped up** to ensure efficient scaling-up of developmental spending. Drawing on CD from IFIs and development partners, LICs can enhance domestic revenue mobilization, public financial management, debt management, and economic governance.

B. Emerging-market economies

For African EMs, accelerated reforms, supported by the international community, will need to play a key role in meeting the financing challenge. In several EMs, space for additional public borrowing is constrained in the context of already high public debt levels and large external exposure. Much of the additional public sector needs should be covered by revenue mobilization, reallocation of spending, addressing contingent liabilities (including from SOEs), and domestic financing. The private sector will need to become the engine of growth in these economies, attracting new investment and creating sustainable jobs. There is scope for mobilizing significant additional external financing for the private sector in African EMs. And international support is available to provide incentives to accelerate this agenda through financial resources and CD.

This, in turn, will require a multi-year agenda of social and economic transformation, with policies that support an enabling environment for the private sector. Efforts should focus on reenergizing pre-pandemic reforms to promote private sector-led and more inclusive growth while also adapting countries' economic models to the post-pandemic world. In this context, governments should:

- *Restore pre-pandemic reform priorities.* Revisiting the role and size of the public sector in economic activity will help crowd in private sector investment while improving the efficiency of more strategic public corporations will help reduce fiscal costs and risks. These reforms should go hand-in-hand with institutional and governance reforms to minimize regulatory 'red tape' and strengthen competition, thereby providing a more job-friendly environment for the private sector. Similarly, easing labor markets regulations while strengthening targeted social safety nets will facilitate private sector job creation while protecting those in need. Given the role of SMEs in job creation in these economies, strengthening access to finance while deepening domestic capital markets will help catalyze entrepreneurship and private investment. Last, fostering trade integration, including through greater integration into global supply chains will expand growth and job opportunities.

- *Implement a transformational agenda*. Countries should stand ready to invest in technologies that can spur transformational growth. The digital transition has started and should be strengthened—in fact, many countries have leveraged digital platforms during the crisis to expand social assistance, as well as health and education services. Investing in adaptation to climate change can also generate high returns and create much needed jobs (IMF, 2020). Advancing digitalization and green investment will underpin the transformation of these economies. In parallel, countries will need to align education with the skills needed in tomorrow's marketplace.

In parallel, governments will need to further strengthen their policy frameworks and create policy space. In this context, transformative fiscal reforms that increase spending efficiency and enhance revenue mobilization, will stimulate economic growth, and help create room for additional spending for health, education, and social safety nets. For example, waste in public investment spending is often systemic: in African EMs, on average over one-third of resources spent on creating and maintaining public infrastructure are lost because of inefficiencies (Schwartz and others, 2020). These inefficiencies are often linked to poor infrastructure governance (Albino-War and others, 2014). Strengthening planning, appraisal, selection, and implementation of public investment projects could substantially increase growth (IMF, 2015). Similarly, boosting the efficiency of social spending by enhancing its targeting would significantly improve socioeconomic outcomes and make growth more inclusive (Mathai and others, 2020). Reforms on revenue mobilization could raise up to US$95 billion over 2021-2025, by broadening the tax base, consolidating multiple VAT rates, increasing tax progressivity, and strengthening tax administration (Jewell and others, 2015). In particular, the abolition of exemptions and preferential treatment in tax matters will help generate additional fiscal resources while promoting equity. More generally, sounder fiscal institutions and management, including through the establishment of medium-term fiscal frameworks and clear spending priorities, will promote accountability and transparency in public accounts, efficiency, as well as debt sustainability.

The international community can support these reform efforts. The IMF will continue to provide resources through its various lending instruments that aim at supporting responses to shocks, accompanying structural transformation, and/or providing insurance against potential shocks. MDBs can also step up their lending and leverage their financing mechanisms to catalyze additional FDI, including by developing risk-sharing and other market-based instruments that facilitate private financing, particularly to SMEs. All IFIs can also support the extensive reform agenda and incentivize countries to accelerate reforms, by providing coordinated capacity development assistance.

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Table A1. Africa: Additional Financing Needs by Country Grouping, 2021–25
(US$ Billions)

	Scenario A					Scenario B		
	(1) Additional COVID spending	(2) Reserve accumulation	(3) Adverse shocks	**Lower bound (1)+(2)**	**Upper bound (1)+(2)+(3)**	(4) Additional investment	**Lower bound (1)+(2)+(4)**	**Upper bound (1)+(2)+(3)+(4)**
Africa	**254.2**	**30.5**	**201.3**	**284.6**	**485.9**	**233.4**	**518.1**	**719.4**
Low-income countries	122.3	14.7	68.4	137.0	205.3	130.1	267.1	335.4
Emerging market economies	131.9	15.8	133.0	147.6	280.6	103.3	251.0	384.0
Resource-intensive	171.0	24.8	124.1	195.8	319.9	122.3	318.1	442.2
Non-resource-intensive	83.1	5.6	77.3	88.8	166.0	111.2	199.9	277.2
Tourism-dependent	32.9	3.2	43.6	36.0	79.6	35.9	71.9	115.5
Fragile	45.0	9.7	32.3	54.7	87.0	49.4	104.1	136.4
G5 Sahel	16.1	1.3	6.2	17.4	23.6	10.2	27.6	33.8
Sub-Saharan Africa	**203.8**	**19.9**	**142.6**	**223.6**	**366.2**	**201.4**	**425.0**	**567.6**
Low-income countries	104.2	12.1	61.7	116.3	178.0	129.3	245.6	307.3
Emerging market economies	99.6	7.8	80.9	107.3	188.2	72.1	179.5	260.4
Resource-intensive	151.1	18.0	99.4	169.1	268.5	122.3	291.4	390.7
Non-resource-intensive	52.7	1.9	43.2	54.5	97.8	79.1	133.7	176.9
Tourism-dependent	2.8	0.3	9.8	3.1	12.9	4.7	7.8	17.6
Fragile	30.3	7.1	16.2	37.4	53.6	48.6	86.0	102.1
North Africa	**50.4**	**10.6**	**58.7**	**61.0**	**119.7**	**32.0**	**93.0**	**151.8**
Low-income countries	18.1	2.6	6.7	20.7	27.3	0.8	21.5	28.2
Emerging market economies	32.3	8.0	52.1	40.3	92.4	31.2	71.5	123.6
Resource-intensive	19.9	6.8	24.7	26.7	51.4	0.0	26.7	51.4
Non-resource-intensive	30.5	3.8	34.1	34.2	68.3	32.0	66.3	100.3
Tourism-dependent	30.0	2.9	33.8	32.9	66.7	31.2	64.2	97.9
Fragile	14.7	2.6	16.1	17.3	33.5	0.8	18.2	34.3

Table A2. Country Groupings

Sub-Saharan Africa

Angola
Benin
Botswana
Burkina Faso
Burundi
Cabo Verde
Cameroon
Central African Republic
Chad
Comoros
Congo, Democratic Republic of the
Congo, Republic of
Côte d'Ivoire
Equatorial Guinea
Eritrea
Eswatini
Ethiopia
Gabon
Gambia, The
Ghana
Guinea
Guinea-Bissau
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritius
Mozambique
Namibia
Niger
Nigeria
Rwanda
São Tomé and Príncipe
Senegal
Seychelles
Sierra Leone
South Africa
South Sudan
Tanzania
Togo
Uganda
Zambia
Zimbabwe

North Africa

Algeria
Djibouti
Egypt
Libya
Mauritania
Morocco
Somalia
Sudan
Tunisia

G5 Sahel

Burkina Faso
Chad
Mali
Mauritania
Niger

Low-Income Countries

Benin
Burkina Faso
Burundi
Cabo Verde
Cameroon
Central African Republic
Chad
Comoros
Congo, Democratic Republic of the
Congo, Republic of
Côte d'Ivoire
Djibouti
Eritrea
Ethiopia
Gambia, The
Ghana
Guinea
Guinea-Bissau
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritania
Mozambique
Niger
Rwanda
São Tomé and Príncipe
Senegal
Sierra Leone
Somalia
South Sudan
Sudan
Tanzania
Togo
Uganda
Zambia
Zimbabwe

Emerging Markets

Algeria
Angola
Botswana
Egypt
Equatorial Guinea
Eswatini
Gabon
Libya
Mauritius
Morocco
Namibia
Nigeria
Seychelles
South Africa
Tunisia

Resource-Intensive Countries (o = oil)

Algeria (o)
Angola (o)
Burkina Faso
Cameroon (o)
Central African Republic
Chad (o)
Congo, Democratic Republic of the
Congo, Republic of (o)
Equatorial Guinea (o)
Gabon (o)
Ghana
Guinea
Liberia
Libya (o)
Mali
Mauritania
Niger
Nigeria (o)
Sierra Leone
Somalia
South Sudan (o)
Sudan
Tanzania
Zambia
Zimbabwe

Tourism-Dependent Countries

Cabo Verde
Comoros
Egypt
Gambia, The
Mauritius
Morocco
São Tomé and Príncipe
Seychelles
Tunisia

Fragile Countries

Benin
Central African Republic
Chad
Comoros
Congo, Democratic Republic of the
Congo, Republic of
Côte d'Ivoire
Djibouti
Eritrea
Gambia, The
Guinea
Guinea-Bissau
Liberia
Libya
Malawi
Mali
São Tomé and Príncipe
Sierra Leone
Somalia
South Sudan
Sudan
Togo
Zimbabwe